Petition and Transcript of Record

Supreme Court of the United States

OCTOBER TERM, 1931

No. 560

CONTINENTAL TIRE AND LUMBER COMPANY, PETITIONER,

vs.

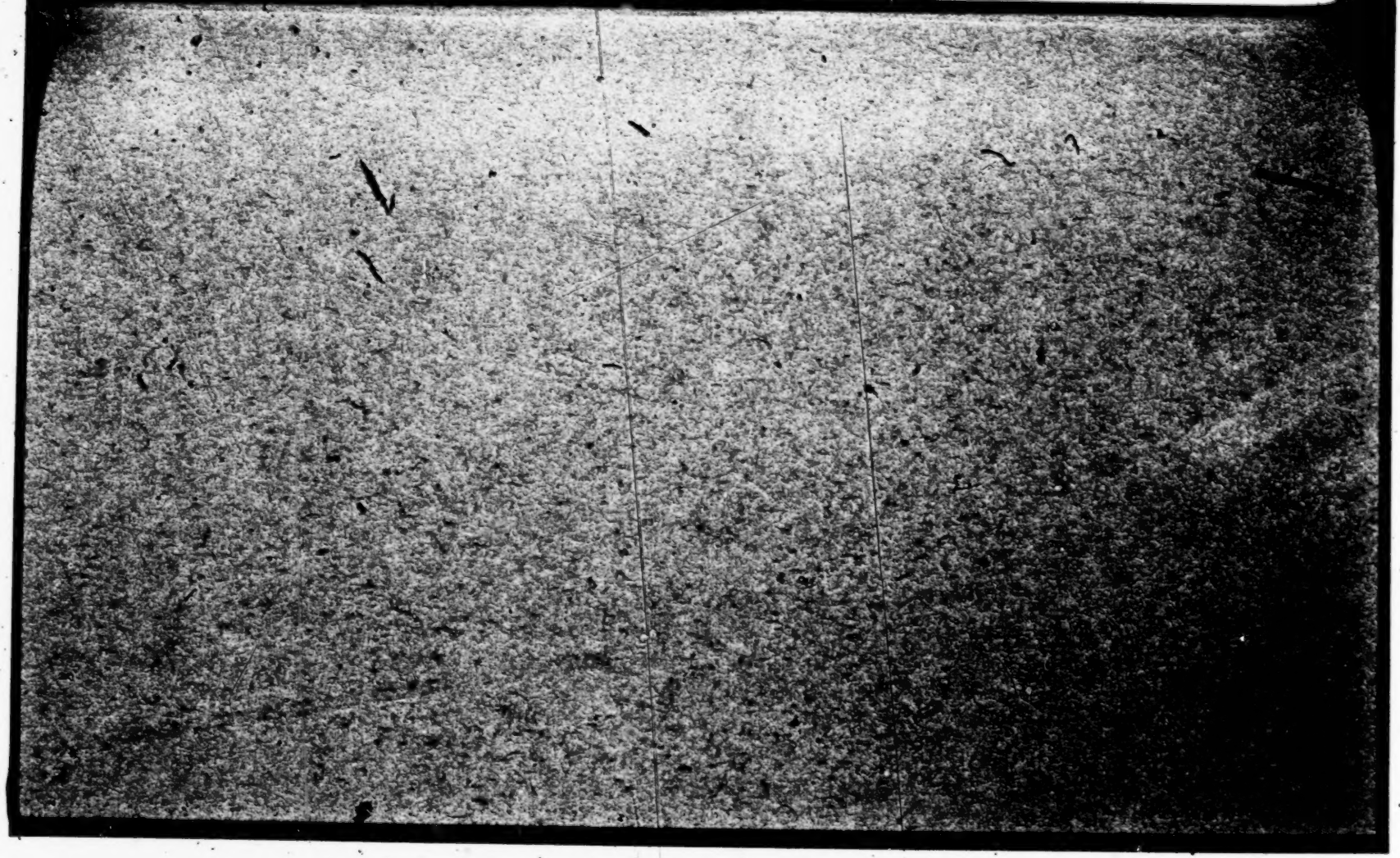
THE UNITED STATES

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

PETITION FOR CERTIORARI FILED DECEMBER 8, 1931

CERTIORARI GRANTED FEBRUARY 15, 1932

(36,374)



(36,374)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1931

No. 560

CONTINENTAL TIE AND LUMBER COMPANY, PETITIONER,

vs.

THE UNITED STATES

ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS

INDEX

	Original	Print
Petition for writ of certiorari	1	1
Record from Court of Claims	1	4
Petition	1	4
Exhibit "A"—Claim for refund	5	6
General traverse	11	11
Argument and submission of case	11	11
Special findings of fact	12	11
Conclusion of law	15	15
Opinion of the court by Littleton, J.	15	15
Judgment	20	21
Clerk's certificate (omitted in printing)	21	
Order allowing certiorari		23

[fol. 1]

IN SUPREME COURT OF THE UNITED STATES

No. 560

CONTINENTAL TIE & LUMBER COMPANY, Petitioner,

v.

THE UNITED STATES OF AMERICA, Respondent

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS OF THE UNITED STATES

Petitioner respectfully shows the Court:

A

Summary Statement of the Matter Involved

This is a petition for a Writ of Certiorari to the Court of Claims involving a decision by that Court rendered October 20th, 1931.

Petitioner is a corporation engaged in the lumber manufacturing business and with principal office at Denver, Colorado. In 1907 petitioner incorporated a logging railroad known as "The Cimarron and Northwestern Railway Company" and ever since that time has owned the entire capital stock of said railroad company.

Throughout the period December 28, 1917, to June 3rd, 1918, inclusive, the Cimarron and Northwestern Railway Company was in possession and control of and operated by the President of the United States, through the Director-General of Railroads. On the latter date the road was relinquished from Federal control by the Director-General.

On October 19th, 1923, the Cimarron and Northwestern [fol. 2] Railway Company received from the Treasurer of the United States the sum of $25,228.35 which was paid to it pursuant to the provisions of Section 204 of the Transportation Act of 1920.

Petitioner rendered a consolidated income tax return for itself and its subsidiary, the Cimarron and Northwestern Railway Company, for the year 1920. In auditing said

return the Commissioner of Internal Revenue included therein as income the aforesaid payment of $25,228.35.

In due time petitioner filed a claim for refund with the Commissioner of Internal Revenue wherein it was contended that said payment under Section 204 of the Transportation Act of 1920 did not constitute taxable income to the Cimarron and Northwestern Railway Company and should not be included in the consolidated net income. The Commissioner of Internal Revenue denied the claim and suit was instituted in the Court of Claims thereon. The Court of Claims agreed with the Commissioner of Internal Revenue and in decision entered October 20th, 1931, held that said amount constituted taxable net income to the Cimarron and Northwestern Railway Company in the year 1920 and should be included in the consolidated net income for said year.

B

Reasons Relied Upon for the Allowance of this Writ

1. Payments to carriers under the provisions of Section 204 of the Transportation Act of 1920 do not constitute taxable income as defined by this Court.

[fol. 3] This Court has held that income is the "gain derived from capital, from labor, or from both combined," including the "profit gained through a sale or conversion of capital assets." Eisner v. Macomber, 40 S. Ct. 189, 252 U. S. 189.

The payment under Section 204 was a gratuity and did not represent gains or profits to petitioner from capital or labor or from the sale of its capital assets.

2. Payments Under Section 204 of the Transportation Act of 1920 do not Constitute Taxable Income because They were not paid Pursuant to any Existing Contract.

The fundamental test of income taxation is that income can arise only through contract, although not all contracts give rise to income.

3. The decision of the Court of Claims is Directly in Conflict with the Decisions of this Honorable Court.

In Edwards v. Cuba Railroad Company, 268 U. S. 628, it was held that money subsidies and property paid to the railroad by the Republic of Cuba were not taxable income

even though they were made upon the express stipulation and understanding that the railroad must extend its lines into new territory. In the instant case the railroad or carrier was not obligated to do anything as a condition to receiving said payment.

4. The Decision of the Court of Claims is in direct conflict with the holdings of the Interstate Commerce Commission upon the Question Involved.

In Finance Docket No. 1176, the Interstate Commerce Commission held that payments to railroads under Section [fol. 4] 209 of the Transportation Act were gratuities (even though the railroads were required to enter into an agreement with the Government to pay over to the Government a certain amount in excess of a stipulated earning). If payments under Section 209 were gratuities, how much more would this be true of payments under Section 204 where no agreements at all were required from the carrier and where it was required to pay nothing over to the Government.

5. This petition for Certiorari should be Granted Because there are Numerous Other Claims Pending before the Internal Revenue Bureau, the Board of Tax Appeals, and the Courts involving the same issue, which will be controlled by the decision herein.

This question must ultimately be decided by this Honorable Court and it would seem unfair to defer such action thus depriving this petitioner of the benefit of this Court's decision.

Wherefore your petitioner prays that a writ of certiorari be issued out of and under the seal of this Honorable Court directed to the United States Court of Claims commanding that Court to certify and transmit to this Court for review and determination, on a day certain to be therein named, a full and complete transcript of the record and of the proceedings in the case numbered and entitled on its docket as No. J-597, Continental Tie and Lumber Company, Plaintiff, v. The United States, Defendant; and that said judgment as to the item of $25,228.35 here in controversy be reversed by this Honorable Court and that your petitioner may have such other and further relief in the

[fols. 5 & 6] premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

Continental Tie & Lumber Company, Petitioner, by Geo. E. H. Goodner, Counsel for Petitioner.

[fol. 1] IN THE COURT OF CLAIMS

No. J-597

CONTINENTAL TIE AND LUMBER COMPANY, Plaintiff,

v.

UNITED STATES OF AMERICA, Defendant

I. PETITION—Filed August 29, 1928

To the Honorable the Chief Justice and the Judges of the Court of Claims:

Plaintiff respectfully represents to the Court:

1. That this action is brought in this Court under authority of Section 145 of the Judicial Code.

2. That plaintiff is a corporation organized in 1905 and existing under the laws of the State of Colorado with principal office at Denver, Colorado; that ever since organization it has been engaged in the lumber manufacturing business.

3. That it incorporated its logging railroad in 1907 as the Cimarron and Northwestern Railway Company and ever since that time it has owned and controlled all of the capital stock of said Company.

4. That pursuant to the provisions of Section 240 of the Revenue Act of 1918, and the regulations promulgated thereunder by the Treasury Department, plaintiff and the said Cimarron and Northwestern Railway Company filed with the Collector at Denver, Colorado, a consolidated in-[fol. 2] come tax return for 1920 and plaintiff, as the parent or principal company, paid the tax assessed thereon of $3,207.06; that on February 23, 1926, plaintiff filed with said Collector a refund claim, prepared on Treasury Department Form 843, demanding refund of $2,995.49 of the

tax paid by it for 1920; that upon consideration of said claim the Commissioner of Internal Revenue agreed to and allowed all of the contentions made in said claim, except for one small item of $100.00 in deductions, which action would have resulted in the allowance of all the refund claimed, except $10.00, but for the fact that the said Commissioner then for the first time included in income for said year the sum of $27,228.35, which reduced the refund to $262.65; that the said Commissioner notified plaintiff of such action by letter dated September 20, 1926, and thereafter refunded the $262.65.

5. That said sum of $27,228.35 represented money paid to the Cimarron and Northwestern Railway Company in 1923 by the Railroad Administration under the provisions of Section 204 of the Transportation Act of 1920; that no part of said sum was received by said Company in 1920 or accrued on its books during that year; that no part of it was taxable income either to said Railroad Company or to plaintiff; and that all of said payment was an outright gift or donation to said Company.

6. That on March 15, 1927, plaintiff filed with the Collector at Denver, Colorado, a refund claim prepared on Treasury Department Form 843, demanding refund of $2,722.84 of the tax paid for 1920, a copy of which claim is attached hereto, made a part hereof, and marked "Exhibit A"; that said Commissioner rejected said claim in [fol. 3] full and notified plaintiff of such by letter dated May 28, 1927.

7. That, due to the erroneous inclusion in income by the Commissioner of Internal Revenue of the $27,228.35 as herein stated, plaintiff has overpaid its tax by the sum of $2,722.84, no part of which has been refunded and all of which is still retained by the United States.

8. That plaintiff is the sole owner of said claim; that no action other than as aforesaid has been had on this claim in Congress, in the Courts, or in any of the Executive Departments of the Government; that no transfer or assignment of said claim or any interest therein has been made; and that plaintiff is justly entitled to the refund now sought after allowing all just credits and set-offs.

9. That plaintiff has at all times borne true allegiance to the Government of the United States, and that it has not

in any way aided, abetted, or given encouragement to rebellion against said Government.

10. That plaintiff believes the facts stated herein are true.

Wherefore, plaintiff prays judgment against the United States for the sum of $2,722.84, together with interest thereon at 6% per annum from date of payment as provided by law.

Continental Tie and Lumber Company, Plaintiff, by Geo. E. H. Goodner, Attorney.

Address: Munsey Building, Washington, D. C.

[fol. 4] *Duly sworn to by Geo. E. H. Goodner. Jurat omitted in printing.*

[fol. 5] EXHIBIT "A" TO PETITION

(Execute Separate Form for Each Tax Period)

Claim for

Abatement of Tax Assessed
Credit Against Outstanding Assessments
XXX Refund of Taxes Illegally Collected
Refund of Amounts Paid for Stamps
Used in Error or Excess

STATE OF COLORADO,
County and City of Denver, ss:

Continental Tie & Lumber Company, Chamber of Commerce Building, Denver, Colorado.

This deponent, being duly sworn according to law deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below with reference to said statement are true and complete:

Period	Year
From	Jan. 1, 1920
To	Dec. 31, 1920

1. Business in which engaged: Timber and manufacturing lumber.
2. Character of assessment or tax: Income and profits.
3. Amount of assessment or stamps purchased: $2,944.41.
4. Reduction of Tax Liability requested (Income and Profits Tax): $2,722.84.
5. Amount to be abated: $——.
6. Amount to be refunded (or such greater amount as is legally refundable): $2,722.84.
7. Dates of payment (See Collector's receipts or indorsements of canceled checks) 1921.

(If statement covers income tax liability, items 8-11, inclusive, must be answered.)

8. District in which return (if any) was filed: Colorado.
9. District in which unpaid assessment appears: ——

[fol. 6] 10. Amount of overpayment claimed as credit: $——.

11. Unpaid assessment against which credit is asked; period from —— to ——, $——.

Deponent verily believes that this application should be allowed for the following reasons:

See attached sheets 1 to 4 made a part hereof.

(Sgd.) T. A. Schomburg, President.

Rec'd original hereof 3-15-27. By (Sgd.) George T. Evans, Collector of Int. Rev.

Sworn to and subscribed before me this 15th day of March, 1927. My commission expires Dec. 15, 1927. (Sgd.) Anna E. Allen, Notary Public.

On February 23, 1926, taxpayer filed with the Collector at Denver, Colorado, a refund claim demanding refund of $2,995.49 for the year 1920. Upon examination of said claim the Commissioner agreed to all the adjustments claimed and set forth therein except as to a difference of $100.00 in depreciation not now in dispute. But the Commissioner added to income an item not theretofore included in income and therefore not mentioned in said claim. This item is $27,228.35, the amount received by the Cimarron & Northwestern Railway Company, a subsidiary of taxpayer, in 1923, under Section 204 of the Transportation

Act of 1920. The Commissioner holds that this amount was taxable income in 1920. His determination of income and tax liability and action on said claim is set forth in Bureau letter dated September 20, 1926, Symbols IT:CR:G-5-SMC, resulting in an overassessment for 1920 of $262.65. [fol. 7] But for said addition to income, the overassessment would have been $2,985.49, which in effect is the payment of an additional tax by taxpayer because of this new item not before put at issue. In other words, the Commissioner allowed taxpayer's claim as filed (except for the $100.00 difference in income), but proceeded to offset $2,722.84 of the refund by additional tax from an entirely new source and on an entirely new basis, upon which taxpayer has never been heard.

On the basis of the foregoing facts, taxpayer claims the right to file this refund claim under the provisions of Section 284(a) and (b) of the Revenue Act of 1926 (being within four years from said constructive payment of additional tax), and also under the provisions of Section 284(g) of the Revenue Act of 1926, in that a waiver for 1920 was filed with the Commissioner on September 15, 1925, a copy of which waiver is attached hereto and made a part hereof. Furthermore, taxpayer offers this claim as supplemental to and amendatory of said claim filed on February 23, 1926, which said claim is by reference made a part hereof, for the reason that in considering said claim, the Commissioner raised a new issue for the first time which he made the basis of additional tax, and to deny taxpayer the right to file this claim and have it considered would be depriving it of the right to be heard and depriving it of property without due process of law.

Taxpayer denies that the $27,228.35, or any part of it, was taxable income in 1920 for the reason, first, that said payment did not constitute taxable income under the Revenue Act of 1918, and, second, that no part of said payment was received by taxpayer in 1920 and could not have been accrued in that year. Therefore taxpayer demands refund of $2,722.84, the amount of tax which the Commissioner is withholding from taxpayer on this issue, after allowing taxpayer's former claim of February 23, 1926, in full (except for the $100.00 difference in income), together with interest thereon as provided by law. The attached state-

ment shows the method of computing the tax liability and refund as claimed by taxpayer.

[fol. 8] An oral hearing is desired on this claim when it is reached for consideration in Washington, D. C., of which taxpayer's Attorney, Mr. Geo. E. H. Goodner, Munsey Building, Washington, D. C., should be notified.

STATEMENT

Continental Tie & Lumber Company, Cimarron & North-Western Railway Company

Consolidated Income and Tax Liability, 1920

Consolidated Net income stated in Revenue Agent's Report dated April 17, 1926, and Bureau Letter dated September 20, 1926		$31,444.05
Deduct amount received by Cimarron & Northwestern Railway Company under Section 204 of Transportation Act of 1920		27,228.35
Correct net income		$4,215.70

Tax

Net income as above	$4,215.70	
Exemption	2,000.00	
Balance taxable at 10%	$2,215.70	
Tax at 10%		$221.57
Tax assessed March, 1921 (#403310)	$3,207.06	
Overassessment allowed Bur. Letter 6/20/26	262.65	
		2,944.41
Overassessment now claimed as refund		$2,722.84

[fol. 9] (Copy)

(Form 872. 20

Treasury Department, Internal Revenue Service

89 Cole 1120, July 22, 1925.
Distribution Center, Sept. 15, 1925, Con. Ret. Division.

Income and Profits Tax Waiver for Taxable Years Ended Prior to January 1, 1922

Sept. 11, 1925.

In pursuance of the provisions of existing Internal Revenue Laws The Continental Tie and Lbr. Co., a taxpayer of ——, and the Commissioner of Internal Revenue hereby waive the time prescribed by law for making any assessment of the amount of income, excess-profits, or war-profits taxes due under any return made by or on behalf of said taxpayer for the year 1920 and 1921 under existing revenue acts, or under prior revenue acts.

This waiver of the time for making any assessment as aforesaid shall remain in effect until December 31, 1926, and shall then expire except that if a notice of a deficiency in tax is sent to said taxpayer by registered mail before said date and (1) no appeal is filed therefrom with the United States Board of Tax Appeals then said date shall be extended sixty days, or (2) if an appeal is filed with said Board then said date shall be extended by the number of days between the date of mailing of said notice of deficiency and the date of final decision by said Board.

The Continental Tie & Lumber Company, by (Signed) Fred F. Dehn, Assistant Secretary, Taxpayer. By (Signed) S. H. Blair, Commissioner.

OK. HBR.

[fol. 10] If this waiver is executed on behalf of a corporation, it must be signed by such officer or officers of the corporation as are empowered under the laws of the State in which the corporation is located to sign for the corporation, in addition to which, the seal, if any, of the corporation must be affixed.

[fol. 11] II. General Traverse—Filed Oct. 8, 1928

And now comes the Attorney General, on behalf of the United States, and answering the petition of the plaintiff herein, denies each and every allegation therein contained; and asks judgment that the petition be dismissed.

Herman J. Galloway, Assistant Attorney General.

III. Argument and Submission of Case

On February 11, 1931, this case was argued and submitted on merits by Mr. George E. H. Goodner, for the plaintiff, and by Mr. Assistant Attorney General Charles B. Rugg, for the defendant.

[fol. 12] **IV. Special Findings of Fact, Conclusion of Law, and Opinion of the Court by Littleton, J.** —Filed October 20, 1931.

Mr. George E. H. Goodner for the plaintiff.

Mr. Assistant Attorney General Charles B. Rugg for the defendant.

Mr. Lisle A. Smith and Mr. George D. Brabson were on the brief.

This suit was brought to recover $2,722.84, income tax alleged to have been erroneously and illegally collected for 1920, with interest.

The questions are whether in computing taxable income for 1920 on the accrual basis there should be included herein (1) $2,000 paid June 28, 1923, by the Director General of Railroads in settlement of claims arising through Federal control during the period December 28, 1917, to June 3, 1918, inclusive, and (2) $25,228.35 paid by the United States October 19, 1923, pursuant to section 204 of the transportation act of 1920 for reimbursement of deficits during Federal control.

Plaintiff contends that the first item was not income in 1920 and that the second item was not income at all since it was compensation to the carrier arising out of Federal

control which was a gratuity or bounty which was not taxable under the act of 1918.

Special Findings of Fact

1. Plaintiff, a Colorado corporation organized in 1905 with principal office at Denver, was during the taxable year, and had been since its organization, engaged in the lumber-manufacturing business. In 1907 it incorporated a railroad known as the Cimarron and Northwestern Railway Company, and since that year it has continuously owned the entire capital stock of said railroad. For 1920 it filed a consolidated tax return for itself and its subsidiary and paid the tax of $3,207.06 shown thereon in four installments of $800.76 each on March 16 and September 12, 1921, and $801.77 each on June 13 and December 13, 1921.

2. February 23, 1926, plaintiff filed a claim for refund for 1920 of $2,995.49. This claim was duly considered by the commissioner and he agreed and allowed all adjustments claimed and set forth therein except an item of $100 for depreciation which is not now in dispute.

[fol. 13] 3. In the final audit of the return for 1920 the commissioner determined a total consolidated net income of $31,444.05 and a total tax liability of $2,944.41, but included for the first time in plaintiff's income for 1920 the sum of $27,228.35, which inclusion increased plaintiff's income tax for 1920 and reduced the amount of the refund under the claim to $262.65. By letter of September 20, 1926, the commissioner notified the plaintiff of his action and subsequently plaintiff received and accepted a refund of $262.65.

4. The Cimarron & Northwestern Railway Company was in possession and control of and operated by the President of the United States through the Director General of Railroads from December 28, 1917, to June 3, 1918, inclusive, and was relinquished from Federal control by the Director General by his order to the carrier dated June 3, 1918. In arriving at the total net income of $31,444.05, the Commissioner of Internal Revenue included therein $2,000 which was paid to the railway company by the Director General of Railroads on June 28, 1923, pursuant to the final settlement agreement between the Director General and the rail-

way company. A copy of this agreement is in evidence as Exhibit 1 and is made a part hereof by reference.

In arriving at the total consolidated net income aforesaid, the Commissioner of Internal Revenue also included therein $25,228.35, which was the amount paid to the railway company by the Treasurer of the United States on October 19, 1923, under the following circumstances: (a) March 4, 1920, the Interstate Commerce Commission issued an order pursuant to the provisions of section 204 of the transportation act of 1920 and soon thereafter forwarded to the Cimarron & Northwestern Railway Company a form entitled "Report of Deficit Roads under Section 204 of the Transportation Act, 1920," containing appropriate instructions for furnishing the information called for; (b) November 3, 1922, the carrier filed with the Interstate Commerce Commission the information and data requested in said form, giving a summary by months of the carrier's operating income or deficit for the test period of three years from July 1, 1914, to July 1, 1917, and also the operating deficit for the period from January 1, 1918, to February 29, 1920. An accountant for the Interstate Commerce Commission made an inspection of the carrier's accounts and determined that the net credit in carrier's favor for the period June 4, 1918, to February 29, 1920, was $42,594.76; (c) the Bureau of Finance of the Interstate Commerce Commission then considered the carrier's claim, and notified carrier by letter dated April 12, 1923, that no amount remained to be certified to its credit under said act on the information before the bureau, but allowed the carrier to submit additional data as to relative costs between the test period and the period of Federal control during which it operated its own road, this evidence to be considered in deriving a factor which might be applied to the carrier's claim and furnish a basis for its allowance; (d) said additional information was furnished by the carrier, and on October 13, 1923, the Interstate Commerce Commission certified to the Secretary of the Treasury that the carrier, The Cimarron & Northwestern Railway Company, was entitled to the sum of $25,228.35, under section 204 of the transportation act [fol. 14] of 1920, said certificate being based on the report and decision of the commission dated October 13, 1923.

The commission in its decision of October 13, 1923, find-

ing the aforementioned amount of $25,228.35 due the subsidiary of plaintiff, stated:

The Cimarron & Northwestern Railway Company, a corporation of the State of New Mexico, hereinafter termed the carrier, is a steam railroad company which, during the Federal control period, engaged as a common carrier in general transportation, operating a line of railroad between Cimarron and Ponil Park, N. Mex., approximately 27 miles, which connected with the Atchison, Topeka & Santa Fe Railway, a railroad under Federal control. It sustained a deficit in its railway-operating income while under private operation in the Federal control period. It is, therefore, a carrier within the meaning of paragraph (a) of section 204 of the transportation act, 1920.

The carrier was under Federal control from January 1, 1918, to June 3, 1918, inclusive, and is entitled to the benefits of section 204 for the period from June 4, 1918, to February 29, 1920, inclusive. Its return under our circular of March 4, 1920, indicated a net credit of $45,090.57 in its favor for the period from January 1, 1918, to February 29, 1920, inclusive. Our examination of its accounts for the period from June 4, 1918, to February 29, 1920, inclusive, shows the net credit to the carrier for that period to be $42,594.76 before making the adjustments under the provisions of paragraph (f) of section 209, required by paragraph (b) of section 204.

Consideration has been given by us to the adjustment of maintenance charges and applying, so far as practicable, the rule set forth in the proviso of paragraph (a) of section 5 of the standard contract between the director general and carriers under Federal control, we have disallowed $17,366.41 of the maintenance expenditures for the period in question.

We find that there is payable to the carrier under paragraphs (f) and (g) of section 204 of the transportation act, 1920, the sum of $25,288.35 from which no amount is deductible as due to the President, as operator of transportation systems under Federal control, on account of traffic balances or other indebtedness. The carrier has expressed its willingness to accept this amount in final settlement of all its claims against the United States under that section.

An appropriate certificate will be issued.

A copy of this certificate is in evidence as Exhibit 2 and is made a part hereof by reference.

5. The plaintiff and its subsidiary, the Cimarron & Northwestern Railway Company, kept their books and rendered their tax returns on the accrual basis, but did not include the amount of $25,228.35 in the return for 1920 or any subsequent year.

September 15, 1925, plaintiff filed with the commissioner an income and profits tax waiver extending the time for making assessment of any additional tax for 1920 until December 31, 1926.

6. March 15, 1927, plaintiff filed a claim for refund for 1920 of $2,722.84. This claim is in evidence as Exhibit A and is made a part hereof by reference. The commissioner rejected this claim in full and notified the plaintiff of his action May 28, 1927.

7. Plaintiff is the sole owner of the claim here involved and no assignment thereof or any interest therein has been [fol. 15] made, and no action other than as aforesaid has been had in Congress, in the courts, or in any of the executive departments of the Government.

Conclusion of Law

Upon the foregoing special findings of fact, which are made a part of the judgment herein, the court decides, as a conclusion of law, that the plaintiff is entitled to recover $200, with interest.

It is therefore adjudged and ordered that the plaintiff recover of and from the United States the sum of two hundred dollars ($200), with interest at the rate of 6 per cent per annum from December 13, 1921, to such date as the Commissioner of Internal Revenue may determine in accordance with the provisions of section 177 (b) of the Judicial Code, as amended by section 615 of the revenue act of May 29, 1928.

Opinion

Littleton, Judge, delivered the opinion of the court:

The Federal control act provided for the taking over of railroads and the payment of just compensation for the use thereof. The Cimarron & Northwestern Railway Com-

pany was taken over December 28, 1917, and turned back June 3, 1918. The company was paid certain sums at various times but final settlement with the Director General of Railroads was not made until 1923. In that year the company agreed to accept and the Director General paid $2,000 as settlement in full of all claims of the company arising out of Federal control of said railway.

Plaintiff contends that on the accrual basis this amount was income for 1918 but that if it was not income for 1918 it was not income until 1923. Nothing took place in 1920 to fix the accrual in that year. The amount was neither earned, determined, agreed to, nor paid in that year. We are of opinion that this item was not income in 1920. Illinois Terminal Co., 5 B. T. A. 15. Cincinnati, Findlay & Fort Wayne Railway Co., 5 B. T. A. 108. Virginia Carolina Securities Corporation, 6 B. T. A. 84. New Orleans, Texas & Mexico Railway Co., 6 B. T. A. 436. Great Northern Railway Co., 8 B. T. A. 225. Chicago, Rock Island & Pacific Ry. Co., 13 B. T. A. 988. Old Dominion Steamship Co., 16 B. T. A. 264. Kansas City Southern Ry. Co., 16 B. T. A. 665.

With reference to the second item of $25,228.35 paid to the plaintiff by the United States under section 204 of the transportation act of 1920 to make good the deficit of the plaintiff in its operating income for the guaranty period, January 1, 1918, to February 29, 1920, plaintiff contends that this payment was not income within the meaning of the taxing act but was a gratuity or bounty; that it did not arise through any legal obligation of the Government to pay; that it did not arise through contract; and that it was not a gain derived from capital or labor and was not determined, fixed, or allowed until 1923.

Section 204 of the transportation act, approved February 28, 1920, 41 Stat. 456, 460, entitled "Reimbursement of Deficits During Federal Control" provided:

[fol. 16] "Sec. 204. (a) When used in this section—

"The term 'carrier' means a carrier by railroad which, during any part of the period of Federal control, engaged as a common carrier in general transportation, and completed for traffic, or connected, with a railroad under Federal control, and which sustained a deficit in its railway operating income for that portion (as a whole) of the period of Federal control during which it operated its own railroad or system of transportation; but does not include

any street or interurban electric railway which has as its principal source of operating revenue urban, suburban, or interurban passenger traffic or sale of power, heat, and light, or both; and

"The term 'test period' means the three years ending June 30, 1917.

"(b) For the purposes of this section—

"Railway operating income or any deficit therein for the period of Federal control shall be computed in a manner similar to that provided in section 209 with respect to such income or deficit for the guaranty period; and

"Railway operating income or any deficit therein for the test period shall be computed in the manner provided in section 1 of the Federal control act.

"(c) As soon as practicable after March 1, 1920, the commissions shall ascertain for every carrier, for every month of the period of Federal control during which its railroad or system of transportation was not under Federal operation, its deficit in railway operating income, if any, and its railway operating income, if any (hereinafter called 'Federal control return') and the average of its deficit in railway operating income, if any, and of its railway operating income, if any, for the three corresponding months of the test period taken together (hereinafter called 'test period return'): Provided, That 'test period return,' in the case of a carrier which operated its railroad or system of transportation for at least one year during, but not for the whole of, the test period, means its railway operating income, or the deficit therein, for the corresponding month during the test period, or the average thereof for the corresponding months during the test period taken together during which the carrier operated its railroad or system of transportation.

"(d) For every month of the period of Federal control during which the railroad or system of transportation of the carrier was not under Federal operation, the commission shall then ascertain (1) the difference between its Federal control return, if a deficit, and its test period return, if a smaller deficit, or (2) the difference between its test period return, if an income, and its Federal control return, if a smaller income, or (3) the sum of its Federal control return, if a deficit, plus its test period return, if an

income. The sum of such amounts shall be credited to the carrier.

"(e) For every such month the commission shall then ascertain (1) the difference between the carrier's Federal control return, if an income, and its test period return, if a smaller income, or (2) the difference between its test period return, if a deficit, and its Federal control return, if a smaller deficit, or (3) the sum of its Federal control return, if an income, plus its test period return, if a deficit: [fol. 17] The sum of such amounts shall be credited to the United States.

" (f) If the sum of the amounts so credited to the carrier under subdivision (d) exceeds the sum of the amounts so credited to the United States under subdivision (e), the difference shall be payable to the carrier. In the case of a carrier which operated its railroad or system of transportation for less than a year during, or for none of, the test period, the foregoing computations shall not be used, but there shall be payable to such carrier its deficit in railway operating income for that portion (as a whole) of the period of Federal control during which it operated its own railroad or system of transportation.

" (g) The commission shall promptly certify to the Secretary of the Treasury the several amounts payable to carriers under paragraph (f). The Secretary of the Treasury is hereby authorized and directed thereupon to draw warrants in favor of each such carrier upon the Treasury of the United States for the amount shown in such certificate as payable thereto. An amount sufficient to pay such warrants is hereby appropriated out of any money in the Treasury not otherwise appropriated."

The foregoing section was enacted for the benefit of only those railroads engaged as common carriers which had connection with and competed with railroads under Federal control. The benefits of the section were designed not for all such carriers but only those which suffered a genuine deficit in operating income by reason of traffic diversions and other practices of the Railroad Administration. The general intent of the section was to afford relief to carriers which through their service were entitled by the public interest to preservation as a part of the transportation sys-

tem of the country and the specific purpose of the section was to reimburse such railways on account of deficits in their net railway operating income. The legislative history shows that it was the intention of Congress to extend certain aid to railways not under Federal control consisting largely of so-called short lines, in recognition not only of their financial necessities but of injury to them through Federal control and operation of lines with which they connected or competed during the Federal control period.

To sustain a claim under this section a railroad must not only have engaged as a common carrier in general transportation but must have competed for traffic or connected with a railroad under Federal control.[1]

Section 204 differs from section 209 considered by the court in Texas & Pacific Railway Co. v. United States, K-148, decided this date, in that it relates to reimbursements of deficits of railroads, during any part of the period of Federal control, engaged as a common carrier in general transportation, and competed for traffic, or connected, with a railroad under Federal control, which sustained a deficit in its railway-operating income for that portion, as a whole, of the period of Federal control in which it operated its own railroad or system of transportation, but we think the [fol. 18] same reasons which lead to the conclusion that amounts received by railroads from the Government pursuant to section 209 of the transportation act are income subject to taxation under the revenue acts apply to amounts paid by the Government under section 204. We find no reason to assume that Congress intended section 209 as a compensation provision and section 204 as a gratuity or bounty provision. Although in section 204 there is absent the contractual relationship between the carrier and the Government found in section 209, this does not, in our opinion, warrant the conclusion that section 204 was designed to confer a gift or gratuity upon railroads since any

---

[1] Little Cottonwood Company, 65 I. C. C. 189; Mercer Valley R. R. Co., 76 I. C. C. 55; United States and C. R. Co., 76 I. C. C. 455; Manitou & Pacific Railway Company, 94 I. C. C. 767; Bingham & G. Railway Co., 99 I. C. C. 724; Rural Valley Railroad Company, 131 I. C. C. 509; Glenfield & Western Railroad Company, 150 I. C. C. 39.

amount payable thereunder arose from the operation of the railroad by the carrier and the use of capital and labor. We think the receipt by the carrier of an amount sufficient to reimburse it for a deficit in railway-operating income computed in accordance with the provisions of section 204 of the transportation act falls within the definition of income under the sixteenth amendment and the revenue act of 1918 as defined by the Supreme Court. The entire phraseology of the transportation act is directed toward the idea of compensation and a consideration of its history and purpose shows that section 204 was designed to reimburse or compensate particular carriers which had suffiered by reason of the policies and practices of the Railroad Administration through traffic diversions and divisions.

We think there is no merit in the contention of the plaintiff that the amount of $25,228.35 paid to the Cimarron and Northwestern Railway Company by the United States should not be included in income until determined and paid in 1923. The amount represented a deficit in railway-operating income for that portion, as a whole, of the period of Federal control during which the Cimarron and Northwestern Railway Company operated its own rairoad or system of transportation. It kept its books on the accrual basis. Prior to the enactment of the transportation act on February 28, 1920, no right in the Cimarron and Northwestern Railway Company to the receipt of this amount existed. The right to receipt accrued upon the termination of Federal control on March 1, 1920. All that remained to be done was to compute the deficit in accordance with the provisions of the act. The accrual system of accounting, as it has always been applied, requires time for computation and adjustment. The plaintiff had previous knowledge and experience as to the test period whereby the railway-operating income and deficit were to be measured and the transportation act was enacted in ample time for the necessary computations to have been made or reasonably estimated for the purpose of accrual in 1920. No contention is made as to any question of dispute or difference between the parties which might have made an estimate or accrual of the claim of the Cimarron and Northwestern Railway Company impossible. There appears to have been no substantial dispute between the plaintiff and the Interstate Commerce Commission as to its claim. The

authority of the commission consisted in a review and audit of plaintiff's books for the purpose of determining its operating deficit as compared with similar accounts during the test period. It is true that there was considerable delay in the payment of plaintiff's claim but that was due to the failure of plaintiff to report or to submit a complete statement of facts and full information to the commission in response to the circular issued by it.

[fol. 19] Plaintiff relies upon Lucas v. American Code Co., 280 U. S. 445. This case held simply that a taxpayer may not set up a reserve to take care of its own breach of contract where it denies all liability therefor. There was no breach of contract here, no dispute of fact or of law between the plaintiff and the commission, or between the plaintiff and any branch of the Government. Furthermore, the plaintiff in American Code Company was not a common carrier subject to interstate commerce regulations which prescribe its method of accounting. In the American Code Company case, supra, the court stated "It may be assumed that, since the company kept its books on the accrual basis, the mere fact that the exact amount of the liability had not been definitely fixed in 1919 would not prevent the deduction, as a loss in that year, of the amount later paid. But here there are other obstacles. Obviously, the mere refusal to perform a contract does not justify the deduction, as a loss, of the anticipated damages. * * * And, when liability is contested, the institution of a suit does not, of itself, create certainty of loss." We, therefore, conclude that the plaintiff and its affiliated companies are not entitled to exclude from consolidated income for 1920 the amount of the operating deficit of the Cimarron and Northwestern Railway Company for which that company received reimbursement from the United States under section 204 of the Transportation Act of 1920.

Judgment will be entered in favor of plaintiff for $200 with interest, as provided by law. It is so ordered.

Whaley, Judge; Williams, Judge; Green, Judge; and Booth, Chief Justice, concur.

[fol. 20] JUDGMENT

At a Court of Claims held in the City of Washington on the 20th day of October, A. D., 1931, judgment was ordered to be entered as follows:

Upon the special findings of fact, which are made a part of the judgment herein, the court decides, as a conclusion of law, that the plaintiff is entitled to recover.

It is therefore adjudged and ordered that the plaintiff recover of and from the United States the sum of Two hundred dollars ($200), with interest at the rate of 6 per cent per annum from December 13, 1921, to such date as the Commissioner of Internal Revenue may determine in accordance with the provisions of section 177 (b) of the Judicial Code, as amended by section 615 of the revenue act of May 29, 1928.

[fol. 21] Clerk's certificate to foregoing transcript omitted in printing.

Endorsed on cover: File No. 36,374. Court of Claims. Term No. 560. Continental Tie and Lumber Company, petitioner, vs. The United States. Petition for a writ of certiorari and exhibit thereto. Filed December 8, 1931. File No. 36,374.

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed February 15, 1932

The petition herein for a writ of certiorari to the Court of Claims is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(1708)

FILE COPY

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1931.

No. 560.

CONTINENTAL TIE AND LUMBER COMPANY,
PETITIONER,

v.

THE UNITED STATES.

Brief in Support of Petition for Writ of Certiorari.

GEO. E. H. GOODNER,
Attorney for Petitioner,
Munsey Building,
Washington, D. C.

INDEX.

Brief of Petitioner 1
I. The Opinion of the Court Below 1
II. Jurisdiction 1
III. Statement of the Case 2
IV. The Law Involved 2
V. Specifications of Error 2
VI. Argument 3
1. Payments under Section 204 of the Transportation Act of 1920 do not constitute taxable income 4
2. Even if it should be held that the payment to the Cimarron and Northwestern Railway Company in 1923 constituted taxable income under Section 204 of the Transportation Act of 1920, it was not income within the year 1920 8
VII. Conclusion 10
Appendix 11

CITATIONS.

Judicial Code, Sec. 240 1
Revenue Act of 1918:
Sec. 213 (a) 3, 11
Sec. 213 (b) (3) 3, 11
Sec. 240 3
Revenue Act of 1926:
Sec. 1003 1
Transportation Act of 1920:
Sec. 204 ..... 7, 11
Sec. 204 (h) 7
Sec. 209 5
Edwards *v.* Cuba R. R. Co., 45 S. Ct. 614; 268 U. S. 628 ..... 2, 6
Eisner *v.* Macomber, 40 S. Ct. 189; 252 U. S. 189 ..... 2, 4
Lucas *v.* American Code Co., 50 S. Ct. 202; 280 U. S. 445 9
U. S. *v.* Anderson, 46 S. Ct. 131; 269 U. S. 422 8

I. C. C. Finance Docket No. 1176 5

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1931.

No. 560.

CONTINENTAL TIE AND LUMBER COMPANY, *Petitioner*,

v.

THE UNITED STATES.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I. THE OPINION OF THE COURT BELOW.

The opinion of the Court of Claims was handed down on October 20th, 1931. It is not yet reported but appears at page 15 of the record. The judgment of the Court was entered on October 20th, 1931, and appears at page 21 of the record.

II. JURISDICTION.

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code as amended by the Act of February 13th, 1925 (U. S. C., Title 28, Sec. 288), and under Section 1003 of the Revenue Act of 1926 (U. S. C., Title 26, Sec. 1226).

The Court of Claims held that a payment of $25,228.35 received by the Cimarron and Northwestern Railway Company on October 19th, 1923, pursuant to the provisions of Section 204 of the Transportation Act of 1920 (41 Stat. 456, 460), constituted taxable income to said Company in the year 1920 and should be included in computing the consolidated net income of said Company and petitioner for said year.

In so holding the Court of Claims decided an important

question of Federal law, contrary to the applicable decisions, of this Honorable Court,

Eisner v. *Macomber*, 40 S. Ct. 189, 252 U. S. 189,
Edwards v. *Cuba R. R. Co.*, 45 S. Ct. 614, 268 U. S. 628;

contrary to the holding upon the same issue by the Interstate Commerce Commission, which agency was charged with the interpretation and administration of the Transportation Act of 1920 (I. C. C. Finance Docket No. 1176); and contrary to the fundamental principle of income taxation, namely, that income can arise only through contract.

Furthermore, the decision of the Court of Claims in this case is of widespread interest because of the many cases involving the same question now pending before the Bureau of Internal Revenue, the United States Board of Tax Appeals, and the Courts.

III. STATEMENT OF THE CASE.

A full statement of the case appears under the heading "A" of the Petition and in the interest of brevity it is not repeated here.

IV. THE LAW INVOLVED.

The statutory provisions involved are set out in the appendix hereto, consisting of excerpts from the Revenue Act of 1918 and the Transportation Act of 1920.

V. SPECIFICATIONS OF ERROR.

1. The Court of Claims erred in finding and holding that the payment in 1923 of $25,228.35 to the Cimarron and Northwestern Railway Company, under the provisions of Section 204 of the Transportation Act of 1920, constituted taxable income to said Company.

2. The Court of Claims erred in finding and holding that the payment of $25,228.35 to the Cimarron and Northwestern Railway Company in 1923 under the provisions of Section 204 of the Transportation Act of 1920, even though taxable, constituted income in 1920.

3. The Court of Claims erred in entering judgment for petitioner only in the amount of $200.00, when it should have given judgment also for $2,522.84, representing the tax paid on the item of $25,228.35 here in controversy.

ARGUMENT.

The question here is as to the taxability in 1920 of a payment made to the Cimarron and Northwestern Railway Company in 1923 of $25,228.35, under the provisions of Section 204 of the Transportation Act of 1920.

The Cimarron and Northwestern Railway Company was affiliated with petitioner throughout 1920 within the purview of Section 240 of the Revenue Act of 1918, and the two companies rendered a consolidated income tax return for that year. The two companies kept books and rendered returns on the accrual basis. (See Finding 5 of the Court, R. 15.)

Section 213 (a) of the Revenue Act of 1918 (set out in full in the appendix), provides that all gains and profits of a taxpayer shall be included in gross income. Invoking the authority of this section the Commissioner of Internal Revenue included in 1920 income the item of $25,228.35 here in dispute.

Section 213 (b) (3) of the Revenue Act of 1918 (see appendix) provides that the value of property acquired by gift shall be excluded from gross income. Under the provisions of this section petitioner contends that the item of $25,228.35 should be excluded from gross income.

The argument then resolves itself into two questions:

First. Did the payment to the Cimarron and Northwestern Railway Company under the provisions of Section 204 of the Transportation Act of 1920 constitute gains or profits to it?

Second. If it did, was that gain or profit taxable in 1920 or in 1923 when it was determined and paid?

These questions form the basis of the following argument:

1. Payments under Section 204 of the Transportation Act of 1920 do not constitute taxable income.

The question of what constitutes taxable income has been before this Honorable Court a number of times. In *Eisner* v. *Macomber*, 40 S. Ct. 189; 252 U. S. 189, a case arising under the Revenue Act of 1916, this Court said:

> "(6) After examining dictionaries in common use (Bouv. L. D.; Standard Dict.; Webster's Internat. Dict.; Century Dict.), we find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of 1909 (Stratton's Independence *v.* Howbert, 231 U. S. 399, 415, 34 Sup. Ct. 136, 140 [58 L. Ed. 285]; Doyle *v.* Mitchell Bros. Co., 247 U. S. 179, 185, 38 Sup. Ct. 467, 469 [62 L. Ed. 1054]), 'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the Doyle Case, 247 U. S. 183, 185, 38 Sup. Ct. 467, 469 (62 L. Ed. 1054). * * *
>
> * * * * * * * *
>
> "The government, although basing its argument upon the definition as quoted, placed chief emphasis upon the word 'gain,' which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived. '*Derived—from—capital*'; '*the gain—derived—from—capital*,' *etc.*"

Nothing has been added to or taken from this definition of income since it was promulgated in 1919.

Obviously the payment under Section 204 was not derived from capital or labor of the Cimarron and Northwestern Railway Company and was not derived from the sale of any of its capital assets. *It therefore does not fall within the definition of income as stated by this Honorable Court.*

The payment under Section 204 was not a payment of any obligation due to the Cimarron and Northwestern Railway Company from the United States. The payment of $2,000.00 on June 28th, 1923, by the Director-General of Railroads

was settlement in full of all claims arising out of federal control and constituted the final settlement between the Director-General and the Cimarron and Northwestern Railway Company. (See first paragraph of Finding 4 of the Court of Claims, R. 12.) On October 13, 1923, after said final settlement was made, the Interstate Commerce Commission determined that $25,228.35 was due the Cimarron and Northwestern Railway Company under Section 204 of the Transportation Act and thereupon certified that amount to the Secretary of the Treasury for payment. *Thus the payment in question was not the fulfillment of any obligation on the part of the Government.* It was nothing more than a bounty or subsidy which Congress saw fit to give and, therefore, *a gift* to be excluded from income under Section 213.(b) (3) of the Revenue Act of 1918. (See appendix.)

The Transportation Act of 1920 provided for the turning back of the railroads to the carriers and for settlement of all differences and compensation due. It is interesting to note that the payment therein provided to be made to the trunk line railroads which were turned back at that time under Section 209 of the Act is referred to as a guaranty, while in Section 204 of the Act, which deals with short line railroads not then under Federal Control, *Congress studiously avoided using the term guaranty or any term implying compensation.*

It is patent that "income" as defined by this Honorable Court arises only through contract, express or implied. In Finance Docket No. 1176 the Interstate Commerce Commission, having under consideration the provisions of Section 209 of the Transportation Act of 1920, said:

> "The guaranty under section 209 is wholly independent of any damages which the carriers may have suffered by reason of the temporary taking of their property during the period of federal control. For all such damages the government must render just compensation; and by their acceptance of the provisions of section 209 the carriers have in no way surrendered or abated any claims arising out of federal operation. The guaranty, therefore, *was not founded upon a legal obligation*, but upon the thought that in fairness it was the duty of the government to protect the income of the carriers, following

> the termination of federal control, until such time as higher rates could be made effective under the provisions of section 15a of the interstate commerce act." (Italics supplied.)

The Interstate Commerce Commission is the governmental agency which has construed and applied the Transportation Act of 1920. All of its dealings and settlements with the railroads and all accounting matters since July 12, 1921, the date of that decision, have been made in the light of the above quoted interpretation and holding. *Then, if the guaranty payments made to the trunk line railroads under section 209 were "not founded upon a legal obligation" of the Government, and therefore not income, how much more true would this be of the payments made under Section 204 to short line railroads which had previously been relinquished from Federal control and with whom settlements in full had been made.*

In *Edwards* v. *Cuba Railroad Company*, 45 Sup. Ct. 614, 268 U. S. 628, this Honorable Court held that subsidies paid to the railroad by the Cuban Government did not constitute taxable income within the meaning of the 16th Amendment to the Constitution, even though the railroad had to comply with certain definite requirements in order to receive the subsidies, among which was the building of additional lines into new territory. In its opinion the Court, among other things, said:

> "The subsidy payments taxed were not made for services rendered or to be rendered. They were not profits or gains from the use or operation of the railroad, and do not constitute income within the meaning of the Sixteenth Amendment. See Stratton's Independence *v.* Howbert, 231 U. S. 399, 415, 34 S. Ct. 136, 58 L. Ed. 285; Eisner *v.* Macomber, 252 U. S. 189, 207, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570; Merchants' Loan & Trust Co. *v.* Smietanka, supra."

In the Cuba Railroad case the railroad was required to do certain things and construct certain lines in addition to operating its railroad. In the instant case the railroad was not

required to do anything in order to be entitled to the payment other than to operate its road during the 6 months following February 29th, 1920,—a thing it would have done irrespective of the provisions of Section 204 of the Transportation Act. If the subsidies paid by the Cuban Government were not for services and were not profit or gain from the use or operation of the railroad, how much more true is it that the payments made to short line railroads by the United States under Section 204 of the Transportation Act of 1920 did not constitute "income."

Section 204 placed no obligation on the railroads. The obligation was on the Interstate Commerce Commission to ascertain and certify to the Secretary of the Treasury the amounts to be paid and on the Secretary of the Treasury to pay such amounts as were certified. If these payments had been obligations, the government would doubtless have hastened settlement and payment. On March 4, 1927, Congress amended Section 204 by adding thereto a new paragraph reading as follows:

> "(h) This section shall not be applicable to any carrier which has not, on or before the expiration of sixty days after this subdivision takes effect, filed with the commission a statement, compiled substantially in the manner prescribed in this section, showing the amount claimed to be due such carrier under this section." (U. S. C. Title 49, Sec. 73 (h) .)

Thus the only requirement imposed on the short line railroads was imposed in 1927, after petitioner and most of the other railroads had been paid. This amendment discloses an intent on the part of Congress not to fulfill an obligation of the Government but to fix a time when its generosity should cease.

Wherefore, it is submitted that the payment of $25,228.35 to the Cimarron and Northwestern Railway Company in 1923, under the provisions of Section 204 of the Transportation Act of 1920, did not constitute taxable income to it.

2. Even if it should be held that the payment to the Cimarron and Northwestern Railway Company in 1923 constituted taxable income under Section 204 of the Transportation Act of 1920, it was not income within the year 1920.

The determination of the amount payable under Section 204 of the Transportation Act of 1920 was an administrative act imposed by Congress on the Interstate Commerce Commission, from which the carrier had no appeal. The amount determined by the Interstate Commerce Commission was certified to the Secretary of the Treasury who was charged with the duty of paying such amount.

On April 12th, 1923, the Interstate Commerce Commission, by letter, notified the Cimarron and Northwestern Railway Company that there was nothing due it under Section 204. Nothing was accrued and nothing could have been accrued as payable to the carrier up to this time. (Finding 4 of the Court, R. 13.)

On June 28th, 1923, the Railroad and the Director-General made a final settlement. (Finding 4 of the Court, R. 12.) Any liability of the Government to the railroad would have been adjusted in that settlement and any accrual in 1920 would have been taken into consideration. Not until October 13, 1923, did the Interstate Commerce Commission determine an amount payable to the railroad and certify such amount to the Secretary of the Treasury for payment. *Then and only then could the railroad have accrued on its books an amount due it. U. S.* v. *Anderson*, 46 S. Ct. 131; 269 U. S. 422.

It might be argued that all of the factors were known in 1920 from which the amount due the railroad could have been determined, but the facts indicate otherwise. One accountant for the Interstate Commerce Commission determined that the railroad was entitled to $42,594.76. Following this the Bureau of Finance of the Interstate Commerce Commission determined that there was nothing due to the carrier. However, by re-determining various costs and factors (which was entirely within its own prerogative and power) the Interstate Commerce

Commission finally reached a determination on October 13, 1923. (See Finding of Fact No. 4 of the Court, R. 4–6.) Thus even an approximate accrual before this date would have been impossible. In its argument upon this point before the Court of Claims, petitioner relied upon the decision of this Honorable Court in *Lucas* v. *American Code Company, Inc.*, 50 S. Ct. 202, 280 U. S. 445. The Court of Claims, in its opinion, held that the American Code Company decision is not in point, and said (R. 21):

> "Furthermore, the plaintiff in American Code Company was not a common carrier subject to Interstate Commerce Regulations which prescribe its method of accounting."

But the Cimarron and Northwestern Railway Company *is a common carrier and its method of accounting is prescribed by the Interstate Commerce Commission.* It is not believed that the Interstate Commerce Commission would require the Cimarron and Northwestern Railway Company to accrue in 1920 a payment under Section 204 of the Transportation Act, *when the Interstate Commerce Commission itself had not, in 1920, even begun to determine whether there was any amount payable or not.*

Petitioner insists that the principles enunciated in the *American Code Company* case (*supra*) are controlling here, especially in view of the fact that the Cimarron and Northwestern Railway Company had no claim or right to any amount whatever until the Interstate Commerce Commission, which had exclusive jurisdiction of the matter, made its determination in 1923.

Wherefore, it is submitted that even if the payment to the Cimarron and Northwestern Railway Company under Section 204 of the Transportation Act is held to be taxable income, it was not income in 1920 and was not taxable until 1923, the year in which the determination was made and the amount was paid.

VII. CONCLUSION.

In view of the foregoing it is respectfully submitted that this Honorable Court should reverse and set aside the decision and judgment of the Court of Claims so far as it pertains to the item of $25,228.35 which was paid to the Cimarron and Northwestern Railway Company in 1923 under the provisions of Section 204 of the Transportation Act of 1920, and hold that such payment did not constitute taxable income to the recipient or, if it was taxable income, that it was returnable in the year 1923 when the amount was determined and paid.

Wherefore, it is respectfully submitted that this case is one calling for the exercise by this Court of its supervisory power, not only in order that the law may be correctly construed, but also in order that taxpayers generally may not be deprived of due process of law by the taking of their property through taxation and depriving them of the rights of judicial determination and that to such an end a writ of certiorari should be granted and this Court should review the decision of the Court of Claims and finally reverse it as above stated.

Respectfully submitted,

GEO. E. H. GOODNER,
Attorney for Petitioner,
Munsey Building,
Washington, D. C.

APPENDIX.

Excerpts from the Revenue Act of 1918:

"Sec. 213. That for the purposes of this title * * * the term 'gross income'—

"(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of Section 212, any such amounts are to be properly accounted for as of a different period; but

"(b) Does not include the following items, which shall be exempt from taxation under this title:

* * * * * * * * *

"(3) The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income); * * *."

Excerpts from the Transportation Act of 1920:

"Sec. 204. (a) When used in this section—

"The term 'carrier' means a carrier by railroad which, during any part of the period of Federal control, engaged as a common carrier in general transportation, and competed for traffic, or connected, with a railroad under Federal control, and which sustained a deficit in its railway operating income for that portion (as a whole) of the period of Federal control during which it operated its own railroad or system of transportation; but does not include any street or interurban electric railway which has as its principal source of operating

revenue urban, suburban, or interurban passenger traffic or sale of power, heat, and light, or both; and

"The term 'test period' means the three years ending June 30, 1917.

"(b) For the purposes of this section—

"Railway operating income or any deficit therein for the period of Federal control shall be computed in a manner similar to that provided in section 209 with respect to such income or deficit for the guaranty period; and

"Railway operating income or any deficit therein for the test period shall be computed in the manner provided in section 1 of the Federal Control Act.

"(c) As soon as practicable after March 1, 1920, the Commission shall ascertain for every carrier, for every month of the period of Federal control during which its railroad or system of transportation was not under Federal operation, its deficit in railway operating income, if any, and its railway operating income, if any (hereinafter called 'Federal control return'), and the average of its deficit in railway operating income, if any, and of its railway operating income, if any, for the three corresponding months of the test period taken together (hereinafter called 'test period return'): *Provided*, That 'test period return' in the case of a carrier which operated its railroad or system of transportation for at least one year during, but not for the whole of, the test period, means its railway operating income, or the deficit therein, for the corresponding month during the test period, or the average thereof for the corresponding months during the test period taken together, during which the carrier operated its railroad or system of transportation.

"(d) For every month of the period of Federal control during which the railroad or system of transportation of the carrier was not under Federal operation, the Commission shall then ascertain (1) the difference between its Federal control return, if a deficit, and its test period return, if a smaller deficit, or (2) the difference between its test period return, if an income, and its Federal control return, if a smaller income, or (3) the sum of its Federal control return, if a deficit, plus its test period return, if an income. The sum of such amounts shall be credited to the carrier.

"(e) For every such month the Commission shall then ascertain (1) the difference between the carrier's Federal control return, if an income, and its test period return, if a smaller income, or (2) the difference between its test period

return, if a deficit, and its Federal control return, if a smaller deficit, or (3) the sum of its Federal control return, if an income, plus its test period return, if a deficit. The sum of such amounts shall be credited to the United States.

"(f) If the sum of the amounts so credited to the carrier under subdivision (d) exceeds the sum of the amounts so credited to the United States under subdivision (e), the difference shall be payable to the carrier. In the case of a carrier which operated its railroad or system of transportation for less than a year during, or for none of, the test period, the foregoing computations shall not be used, but there shall be payable to such carrier its deficit in railway operating income for that portion (as a whole) of the period of Federal control during which it operated its own railroad or system of transportation.

"(g) The Commission shall promptly certify to the Secretary of the Treasury the several amounts payable to carriers under paragraph (f). The Secretary of the Treasury is hereby authorized and directed thereupon to draw warrants in favor of each such carrier upon the Treasury of the United States for the amount shown in such certificate as payable thereto. An amount sufficient to pay such warrants is hereby appropriated out of any money in the Treasury not otherwise appropriated."

FILE COPY

APR 1 1

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1931.

No. 560.

CONTINENTAL TIE AND LUMBER COMPANY,
PETITIONER,

v.

THE UNITED STATES.

Brief of Petitioner On Writ of Certiorari to the Court of Claims.

GEO. E. H. GOODNER,
Attorney for Petitioner,
Munsey Building,
Washington, D. C.

JOHN G. BUCHANAN,
PAUL G. RODEWALD,
Of Counsel.

INDEX.

Brief of Petitioner 1
I. The Opinion of the Court Below 1
II. Jurisdiction 1
III. Statement of the Case 1
IV. The Law Involved 2
V. Specifications of Error 3
VI. Argument 3
A. Payments under Section 204 of the Transportation Act of 1920 do not constitute taxable income 4
B. Even if it should be held that the payment to the Cimarron and Northwestern Railway Company in 1923 constituted taxable income under Section 204 of the Transportation Act of 1920, it was not income within the year 1920 8
1. The Cimarron and Northwestern Railway Company had no enforceable claim against the United States in 1920 8
2. The events which fixed the amount payable had not all occurred in 1920 10
3. No determination of any amount payable was made by the Interstate Commerce Commission until 1923 17
VII. Conclusion 22
Appendix 23
Excerpts from the Revenue Act of 1918 23
Excerpts from the Transportation Act of 1920 23

CITATIONS.

Judicial Code, Sec. 240 1

Revenue Act of 1918:

Sec. 213 (a) 3
Sec. 213 (b) (3) 3, 5
Sec. 240 3

Revenue Act of 1926:

Sec. 1003 1

Transportation Act of 1920:

Sec. 204 ..... 2, 7, 10, 15
Sec. 209 ..... 5, 11
Sec. 212 ..... 15, 16
Urgent Deficiencies Act of October 22, 1913, 38 Stat. 208 9
Burnet *v.* Sanford & Brooks Co., 282 U. S. 359 ..... 20, 22
Edwards *v.* Cuba R. R. Co., 268 U. S. 628 6
Eisner *v.* Macomber, 252 U. S. 189 4
Great Northern Ry. Co. *v.* U. S., 277 U. S. 172 9
I. C. C. *v.* U. S. 17 Fed. (2d) 860 9
Lucas *v.* American Code Co. Inc., 280 U. S. 445 19
Northern Pac. R. R. Co. *v.* I. C. C., 23 Fed. (2d) 221; certiorari denied, 275 U. S. 572 ..... 9, 15
Old Colony R. R. Co. *v.* Com. 52 S. Ct. 211 20
U. S. *v.* Anderson, 269 U. S. 422 21
U. S. ex. rel. Abilene & L. Railway Co. *v.* I. C. C., 8 Fed. (2d) 901; certiorari denied, 270 U. S. 650 9
U. S. Cartridge Co. *v.* U. S. 52 S. Ct. 243 19
Williamsport Wire Rope Co. *v.* U. S. 277 U. S. 551 9
Finance Docket No. 1600, 66 I. C. C. 765 16
Finance Docket No. 1606, 70 I. C. C. 711 12
Finance Docket No. 1176, 70 I. C. C. 115 ..... 5, 12
Finance Docket No. 136, 71 I. C. C. 492 16
Finance Docket No. 107, 71 I. C. C. 823 16
Finance Docket No. 118, 71 I. C. C. 825 16
Finance Docket No. 1550, 71 I. C. C. 853 16
Finance Docket No. 149, 71 I. C. C. 863 16
Finance Docket No. 2797, 82 I. C. C. 678 13
Finance Docket No. 2500, 99 I. C. C. 724 16
Finance Docket No. 501, 111 I. C. C. 318 14
Finance Docket No. 377, 111 I. C. C. 355 14

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1931.

No. 560.

CONTINENTAL TIE AND LUMBER COMPANY, *Petitioner*,
v.
THE UNITED STATES.

BRIEF OF PETITIONER ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

I. THE OPINION OF THE COURT BELOW.

The opinion of the Court of Claims (R. 15) is reported in 52 Fed. (2d) 1045.

II. JURISDICTION.

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code as amended by the Act of February 13th, 1925 (U. S. C., Title 28, Sec. 288), and under Section 1003 of the Revenue Act of 1926 (U. S. C., Title 26, Sec. 1226).

A petition for certiorari was filed December 8, 1931 (R. 22), and was granted February 15, 1932 (R. 23).

III. STATEMENT OF THE CASE.

The Continental Tie and Lumber Company, petitioner, is a corporation engaged in the lumber manufacturing business and with principal office at Denver, Colorado. In 1907 petitioner incorporated a logging railroad known as "The Cimarron and Northwestern Railway Company" and ever since that time has owned the entire capital stock of said railroad company. (R. 12.)

Throughout the period December 28, 1917, to June 3d, 1918, inclusive, the Cimarron and Northwestern Railway Company was in possession and control of and operated by the President of the United States, through the Director-General of Railroads. On the latter date the road was relinquished from Federal control by the Director-General. (R. 12.)

On October 19th, 1923, the Cimarron and Northwestern Railway Company received from the Treasurer of the United States the sum of $25,228.35 which was paid to it pursuant to the provisions of Section 204 of the Transportation Act of 1920. (R. 13.)

Petitioner rendered a consolidated income tax return for itself and its subsidiary, the Cimarron and Northwestern Railway Company, for the year 1920. In auditing said return the Commissioner of Internal Revenue included therein as income the aforesaid payment of $25,228.35. (R. 12–13.)

In due time petitioner filed a claim for refund with the Commissioner of Internal Revenue wherein it was contended that said payment under Section 204 of the Transportation Act of 1920 did not constitute taxable income to the Cimarron and Northwestern Railway Company and should not be included in the consolidated net income for 1920. The Commissioner of Internal Revenue denied the claim and suit was instituted in the Court of Claims thereon. The Court of Claims agreed with the Commissioner of Internal Revenue and in decision entered October 20th, 1931, held that said amount constituted taxable net income to the Cimarron and Northwestern Railway Company in the year 1920 and should be included in the consolidated net income for said year. (R. 15 and refund claim, R. 6–8.)

IV. THE LAW INVOLVED.

The statutory provisions involved are set out in the appendix hereto, consisting of excerpts from the Revenue Act of 1918 and the Transportation Act of 1920.

V. SPECIFICATIONS OF ERROR.

1. The Court of Claims erred in finding and holding that the payment in 1923 of $25,228.35 to the Cimarron and Northwestern Railway Company, under the provisions of Section 204 of the Transportation Act of 1920, constituted taxable income to said Company.

2. The Court of Claims erred in finding and holding that the payment of $25,228.35 to the Cimarron and Northwestern Railway Company in 1923 under the provisions of Section 204 of the Transportation Act of 1920, even though taxable, constituted income in 1920.

3. The Court of Claims erred in entering judgment for petitioner only in the amount of $200.00, when it should have given judgment also for $2,522.84, representing the tax paid on the item of $25,228.35 here in controversy.

VI. ARGUMENT.

The question here is as to the taxability in 1920 of a payment made to the Cimarron and Northwestern Railway Company in 1923 of $25,228.35, under the provisions of Section 204 of the Transportation Act of 1920.

The Cimarron and Northwestern Railway Company was affiliated with petitioner throughout 1920 within the purview of Section 240 of the Revenue Act of 1918, and the two companies rendered a consolidated income tax return for that year. The two companies kept books and rendered returns on the accrual basis. (See Finding 5 of the Court, R. 15.)

Section 213 (a) of the Revenue Act of 1918 (set out in full in the appendix), provides that all gains and profits of a taxpayer shall be included in gross income. Invoking the authority of this section the Commissioner of Internal Revenue included in 1920 income the item of $25,228.35 here in dispute.

Section 213 (b) (3) of the Revenue Act of 1918 (see appendix) provides that the value of property acquired by gift shall be excluded from gross income. Under the provisions of this section petitioner contends that the item of $25,228.35 should be excluded from gross income.

The argument then resolves itself into two questions:

First. Did the payment to the Cimarron and Northwestern Railway Company under the provisions of Section 204 of the Transportation Act of 1920 constitute gains or profits to it?

Second. If it did, was that gain or profit taxable in 1920 or in 1923 when it was determined and paid?

These questions form the basis of the following argument:

A.

Payments under Section 204 of the Transportation Act of 1920 do not constitute taxable income.

The question of what constitutes taxable income has been before this Honorable Court a number of times. In *Eisner* v. *Macomber*, 40 S. Ct. 189; 252 U. S. 189, a case arising under the Revenue Act of 1916, this Court said:

> "(6) After examining dictionaries in common use (Bouv. L. D.; Standard Dict.; Webster's Internat. Dict.; Century Dict.), we find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of 1909 (Stratton's Independence *v.* Howbert, 231 U. S. 399, 415, 34 Sup. Ct. 136, 140 [58 L. Ed. 285]; Doyle *v.* Mitchell Bros. Co., 247 U. S. 179, 185, 38 Sup. Ct. 467, 469 [62 L. Ed. 1054]), 'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the Doyle Case, 247 U. S. 183, 185, 38 Sup. Ct. 467, 469 (62 L. Ed. 1054).
>
> * * * * * * * * * *
>
> "The government, although basing its argument upon the definition as quoted, placed chief emphasis upon the word 'gain,' which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived. *'Derived—from—capital'; 'the gain—derived—from—capital,' etc.*"

Nothing has been added to or taken from this definition of income since it was promulgated in 1919.

Obviously the payment under Section 204 was not derived from capital or labor of the Cimarron and Northwestern

Railway Company and was not derived from the sale of any of its capital assets. *It therefore does not fall within the definition of income as stated by this Honorable Court.*

The payment under Section 204 was not a payment of any obligation due to the Cimarron and Northwestern Railway Company from the United States. The payment of $2,000.00 on June 28th, 1923, by the Director-General of Railroads *was settlement in full of all claims arising out of federal control and constituted the final settlement between the Director-General and the Cimarron and Northwestern Railway Company.* (See first paragraph of Finding 4 of the Court of Claims, R. 12.) On October 13, 1923, after said final settlement was made, the Interstate Commerce Commission determined that $25,228.35 was due the Cimarron and Northwestern Railway Company under Section 204 of the Transportation Act and thereupon certified that amount to the Secretary of the Treasury for payment. *Thus the payment in question was not the fulfillment of any obligation on the part of the Government.* It was nothing more than a bounty or subsidy which Congress saw fit to give and, therefore, *a gift* to be excluded from income under Section 213 (b) (3) of the Revenue Act of 1918. (See appendix.)

The Transportation Act of 1920 provided for the turning back of the railroads to the carriers and for settlement of all differences and compensation due. It is interesting to note that the payment therein provided to be made to the trunk line railroads which were turned back at that time under Section 209 of the Act is referred to as a guaranty, while in Section 204 of the Act, which deals with short line railroads not then under Federal Control, *Congress studiously avoided using the term guaranty or any term implying compensation.*

It is patent that "income" as defined by this Honorable Court arises only through contract, express or implied. In Finance Docket No. 1176 the Interstate Commerce Commission, having under consideration the provisions of Section 209 of the Transportation Act of 1920, said:

> "The guaranty under section 209 is wholly independent of any damages which the carriers may have suffered by reason of the temporary taking of their property during

> the period of federal control. For all such damages the government must render just compensation; and by their acceptance of the provisions of section 209 the carriers have in no way surrendered or abated any claims arising out of federal operation. The guaranty, therefore, *was not founded upon a legal obligation*, but upon the thought that in fairness it was the duty of the government to protect the income of the carriers, following the termination of federal control, until such time as higher rates could be made effective under the provisions of section 15a of the interstate commerce act." (Italics supplied.)

The Interstate Commerce Commission is the governmental agency which has construed and applied the Transportation Act of 1920. All of its dealings and settlements with the railroads and all accounting matters since July 12, 1921, the date of that decision, have been made in the light of the above quoted interpretation and holding. *Then, if the guaranty payments made to the trunk line railroads under section 209 were "not founded upon a legal obligation" of the Government, and therefore not income, how much more true would this be of the payments made under Section 204 to short line railroads which had previously been relinquished from Federal control and with whom settlements in full had been made.*

In *Edwards* v. *Cuba Railroad Company*, 45 Sup. Ct. 614, 268 U. S. 628, this Honorable Court held that subsidies paid to the railroad by the Cuban Government did not constitute taxable income within the meaning of the 16th Amendment to the Constitution, even though the railroad had to comply with certain definite requirements in order to receive the subsidies, among which was the building of additional lines into new territory. In its opinion the Court, among other things, said:

> "The subsidy payments taxed were not made for services rendered or to be rendered. They were not profits or gains from the use or operation of the railroad, and do not constitute income within the meaning of the Sixteenth Amendment. See Stratton's Independence *v.* Howbert, 231 U. S. 399, 415, 34 S. Ct. 136, 58 L. Ed. 285; Eisner *v.* Macomber, 252 U. S. 189, 207, 40 S. Ct. 189,

64 L. Ed. 521, 9 A. L. R. 1570; Merchants' Loan & Trust Co. *v.* Smietanka, supra."

In the Cuba Railroad case the railroad was required to do certain things and construct certain lines in addition to operating its railroad. In the instant case the railroad was not required to do anything [redacted] If the subsidies paid by the Cuban Government were not for services and were not profit or gain from the use or operation of the railroad, how much more true is it that the payments made to short line railroads by the United States under Section 204 of the Transportation Act of 1920 did not constitute "income."

Section 204 placed no obligation on the railroads. The obligation was on the Interstate Commerce Commission to ascertain and certify to the Secretary of the Treasury the amounts to be paid and on the Secretary of the Treasury to pay such amounts as were certified. If these payments had been obligations, the Government would doubtless have hastened settlement and payment. On March 4, 1927, Congress amended Section 204 by adding thereto a new paragraph reading as follows:

> "(h) This section shall not be applicable to any carrier which has not, on or before the expiration of sixty days after this subdivision takes effect, filed with the commission a statement, compiled substantially in the manner prescribed in this section, showing the amount claimed to be due such carrier under this section." (U. S. C. Title 49, Sec. 73 (h).)

Thus the only requirement imposed on the short line railroads was imposed in 1927, after petitioner and most of the other railroads had been paid. This amendment discloses an intent on the part of Congress not to fulfill an obligation of the Government but to fix a time when its generosity should cease.

Wherefore, it is submitted that the payment of $25,228.35

to the Cimarron and Northwestern Railway Company in 1923, under the provisions of Section 204 of the Transportation Act of 1920, did not constitute taxable income to it.

B.

Even if it should be held that the payment to the Cimarron and Northwestern Railway Company in 1923 constituted taxable income under Section 204 of the Transportation Act of 1920, it was not income within the year 1920.

Petitioner and the Cimarron and Northwestern Railway Company kept books and rendered income tax returns on the accrual basis. The question then is:

> Was the payment of $25,228.35 to the Cimarron and Northwestern Railway Company in 1923 under the provisions of Section 204 of the Transportation Act, 1920 (if income at all), *accruable* on its books and in its tax return in the year 1920?

The grounds on which it is contended that this question should be answered in the negative are discussed under the following heads:

1. The Cimarron and Northwestern Railway Company had no enforceable claim against the United States in 1920.
2. The events which fixed the amount payable had not all occurred in 1920.
3. No determination of any amount payable was made by the Interstate Commerce Commission until in 1923.

1. *The Cimarron and Northwestern Railway Company had no enforceable claim against the United States in 1920.*

The payments under Section 204 of the Transportation Act, 1920 (41 Stat. 460), were to reimburse common carrier railroads for deficits incurred by them during that portion of the Federal control period during which they were not under Federal control. (See Section 204, appendix.) At the time of such enactment the said railroads had no enforceable claims for deficits arising in that period. Did the section give rise to any such enforceable claims?

Section 204 provides that the Interstate Commerce Commission "shall ascertain for every carrier" the amounts of such deficits and that it "shall promptly certify to the Secretary of the Treasury the several amounts payable" and that "The Secretary of the Treasury is hereby authorized and directed *thereupon* to draw warrants in favor of each such carrier * * * for the amount shown in such certificate as payable thereto." (Italics added.)

The act makes no provision for appeal from the determination of the Commission and the carrier therefore had no option but to take what the Commission certified and what the Secretary of the Treasury paid. Mandamus would not lie to compel an allowance. *United States ex rel. Abilene & L. Railway Company* v. *Interstate Commerce Commission*, 8 F. (2d) 901, certiorari denied, 270 U. S. 650; *cf. Interstate Commerce Commission* v. *United States*, 17 F. (2d) 860. Nor could the action of the Commission be reviewed by a District Court under the Urgent Deficiencies Act of October 22, 1913, 38 Stat. 208, 220. See *Great Northern Railway Company* v. *United States*, 277 U. S. 172. Nor could the determination by the Commission be reviewed by certiorari. See *Northern Pacific Railroad Company* v. *Interstate Commerce Commission*, 23 F. (2d) 221, certiorari denied, 275 U. S. 572. Nor could suit be brought against the United States for an amount claimed. See *Williamsport Wire Rope Company* v. *United States*, 277 U. S. 551, wherein this Court said:

> "But we have held that the Court of Claims is without jurisdiction where the statute creating the claim expressly refers it for final determination to an executive department. U. S. *v.* Babcock, 250 U. S. 328, 331. And that it is equally without jurisdiction where from an examination of all the terms of the statute it appears that Congress intended to vest final authority in an administrative agency. United States *v.* Atchison, Topeka & Santa Fe Ry. Co., 249 U. S. 451; Silberschein *v.* United States, 266 U. S. 221. Long ago Congress conferred final authority upon such an agency in the enforcement of the appraisal provisions by which the amounts payable under the customs laws are determined. Compare Bartlett *v.* Kane, 16 How. 263, 272; Hilton *v.* Merritt, 110 U. S. 97, 105; Passavant *v.* United States, 148 U. S. 214."

Being thus at the mercy of the Interstate Commerce Commission, the Cimarron and Northwestern Railway Company had no enforceable claim against the United States in 1920 and at no time prior to final determination by the Interstate Commerce Commission in 1923. There could therefore be no accrual in 1920.

2. *The events which fixed the amount payable had not all occurred in 1920.*

The reasoning upon which the Court of Claims reached the conclusion that the payment under Section 204 of the Transportation Act, 1920 (41 Stat. 460) was income for the year 1920 proceeds upon the assumption that the amount to be paid could be computed or reasonably estimated for the purpose of accrual in 1920 from facts then in the possession of the railway company. The carrier's rights, such as they were, were fixed by Section 204, which provides in subdivision (c) that as soon as practicable after March 1, 1920, the Interstate Commerce Commission shall, in effect, ascertain the extent to which the railway operating income of each carrier during the so-called Federal control period fell short of its railway operating income for the corresponding so-called test period. Section 204 (b) provides:

> "(b) For the purposes of this section—
>
> "Railway operating income or any deficit therein for the period of Federal control shall be computed in a manner similar to that provided in section 209 with respect to such income or deficit for the guaranty period."

The Interstate Commerce Commission reports apparently contain no separate general instructions to carriers having claims under Section 204 as to the data to be reported by them to enable the Commission to compute their railway operating income for the control period. Since, however, railway operating income for the Federal control period for the purposes of Section 204 is directed to be computed in a manner similar to that provided in Section 209 (41 Stat. 464) with respect to the so-called guaranty period, it seems clear that amounts payable

to carriers under Section 204 could not be accrued unless amounts payable under Section 209 could also be accrued. An examination of Section 209 and the successive orders issued by the Commission affecting the determination of railway operating income under that section shows, it is submitted, that railway operating income for that period and therefore for the control period under Section 204 could not have been ascertained for the purpose of accruing within the year 1920 amounts payable to carriers under those sections.

Section 209 (f) prescribes the method of computation to be followed. Subdivision (3) provides, "There shall not be included in operating expenses, for maintenance of way and structures, or for maintenance of equipment, more than an amount fixed by the Commission." While it might be supposed from the following sentence, providing for the application so far as practicable of the "rule set forth in the proviso in paragraph (a) of section 5 of the 'standard contract' between the United States and the carriers," that the amount which the Commission would fix under subdivision (3) for maintenance expenses could be rather definitely anticipated, this was not the case, as is shown by the successive orders of the Interstate Commerce Commission, referred to below, issued from time to time after 1920. Again, in Section 209 (f) (5), the Commission is directed to require the elimination and restatement of the operating expenses and revenues (other than for maintenance) for the guaranty period, "to the extent necessary to correct and exclude any disproportionate or unreasonable charge to such expenses or revenues for such period."

The successive instructions issued by the Commission show the impossibility of determining in 1920 how much the Commission would allow either under Section 209 or Section 204. The first set of instructions of the Commission with respect to accounting procedure to be observed by carriers for the purpose of determining railway operating income under Section 209 was issued on June 10, 1920, and is printed at 70 I. C. C. 717. In paragraph 9 the order of the Commission states that "Reserve accounts created to reflect accruals pertaining to guaranty-period transactions will be closed out or adjusted on the basis of actual expenditures within such a reasonable time after

August 31, 1920, as the Commission may determine." This "reasonable time" within which regular accrual-basis entries were to be adjusted to a cash basis was not fixed by the Commission until December 15, 1921, on which date it fixed the termination of the "reasonable time" at December 31, 1921. Finance Docket No. 1606, *Final Settlement under Section 209*, 70 I. C. C. 711, 712. In the meantime, as the report shows at p. 714, it had, by orders of October 18, 1920, and January 5, 1921, required carriers to furnish certain information to enable the Commission properly to discharge its duties under Section 209. From information so obtained and after extensive argument on the part of the carriers, the Commission on July 12, 1921, in Finance Docket No. 1176, *Maintenance Expenses under Section 209*, 70 I. C. C. 115–129, "indicated the general principles for fixing the maximum charges to operating expenses for maintenance under the act." In Finance Docket No. 1606, *supra*, 70 I. C. C. 711, 714, the Commission stated the outcome of its study:

> "Upon consideration of the returns to our orders of October 18, 1920, and January 5, 1921, and as a result of investigations made for the purposes of the definite determinations required for partial payments under section 212 of the act, in addition to the facts considered in Finance Docket No. 1176, *Maintenance Expenses under Section 209*, *supra*, we are of the opinion that the allowances for differences that may exist between the cost of labor and material for the test period and for the guaranty period, respectively, *can not practicably be made upon the basis of any rigid rule or formula, but these allowances must be fixed by us in the exercise of a reasonable judgment upon consideration of all the relevant facts and circumstances.*". (Italics added.)

The complications confronting the Commission fully appear from the pages of its report. The elaborate determination of applicable principles, made by the Commission, at the cost of so much pains and labor as well as disagreement on the part of its members and with the assistance of the entire transportation industry, long after 1920 could not, it is submitted, have been anticipated by any carrier and made the basis of even an estimate for accrual purposes.

The result of this study of maintenance expenses was a general formula for fixing the maximum amounts to be charged to operating expenses for maintenance which is stated at 70 I. C. C. 715–716, in an order promulgated December 15, 1921. In its promulgation the Commission plainly showed that the formula could not be applied by the carriers without further exercise of judgment by the Commission itself, since in the same order (70 I. C. C. 711, 714) the Commission directed carriers to submit *estimates* of the net effect of deferred debits and credits which could not as of December 31, 1921, be definitely determined, for action of the Commission under paragraph (b) of Section 212 of the Transportation Act, 1920. This section was added to the Transportation Act by amendment on February 26, *1921* (41 Stat. 1145) providing for certification by the Commission to the Secretary of the Treasury of partial amounts payable under Section 204 or Section 209. Further mention is made of this provision hereafter.

The Commission in its report of December 15, 1921, 70 I. C. C. 711, 715–716, said, "We will proceed to final settlement of each case upon the filing of the accounting returns now called for by Exhibits A, B, C, and D, and the adjustment return called for by Exhibit E, in the list of forms hereto annexed." These five exhibits cover 28 pages of the report, and the variety of detailed information called for by them can only be appreciated upon direct examination. Most of the information called for evidently had not been required under previous orders of the Commission. It is especially to be noted that by Exhibit D, Schedule 2 (70 I. C. C. 724), and by Exhibit D, Schedule 7 (70 I. C. C. 727), the order of the Commission called for a report of facts which had not happened at the end of 1920. This was quite in accordance with the instruction of Congress in Section 209 (f) (3) and (5).

Further announcement of the Commission's interpretation of Section 209 and its procedure thereunder was made in Finance Docket No. 2797, *Treatment of Salvage, Piece Work and Prices under Section 209*, 82 I. C. C. 678, dealing with factors to be applied to charges to operating expenses for maintenance. It is submitted that the elaborate system of territorial factors and individual differentiation developed by

the Commission between 1920 and 1923, as shown by this report (dated August 15, 1923), could not have been anticipated by any carrier, short line or transcontinental, in 1920.

The published view of the Commission is that the amounts payable under Section 209, and therefore under Section 204, could not be determined in 1920. In Finance Docket No. 501, *Guaranty Settlement with Great Northern Railway Company and Affiliated Companies*, 111 I. C. C. 318, 319-320, the Commission said:

> "It is obvious that the amounts necessary to make good the guaranty to the several carriers could not be determined until after the close of the guaranty period and the closing of the books of accounts of the carriers with respect to the charges attributable to that period, *and until we had determined the principles which should govern in final settlement.* * * *
>
> "When these certificates for partial payments were issued, there were certain questions with respect to the interpretation of section 209 which we had not finally determined, nor were the books of accounts of the carriers closed with respect to the charges attributable to the guaranty period. Hence final ascertainments of the amounts due under the guaranty could not be made. * * *" (Italics added.)

The extent to which the Commission adjusted the railway operating income, as it would ordinarily be calculated from books kept in accordance with its prescribed classifications of accounts, is illustrated by Finance Docket No. 377, *Guaranty Settlement with Chicago, Indianapolis & Louisville Railway*, 111 I. C. C. 355, 357, in which the Commission partially disallowed fire losses suffered during the guaranty period. This ruling was made on the analogy afforded by Section 209, which provides for disallowance of maintenance expenses in excess of an amount fixed by the Commission, based on maintenance expenses during the test period. Irrespective of its merits, the decision could hardly have been anticipated in 1920. It appears also that it was necessary in the cases of some items either to apply a flat formula or make arbitrary separations in book charges. 111 I. C. C. 318, 331. With so

many issues of fact and law depending upon quasi-judicial determination by the Commission, it is submitted that claims under Sections 204 and 209 have the status of litigated claims the amount of which could not be accrued until final judgment.

Even if the formula for determining railway operating income had been sufficiently certain in 1920 to make possible a reasonable estimate of the amount to be paid under Section 204, it is submitted that action by the Commission upon the particular carrier's claim would be a condition precedent to its accrual. Section 204 (c) directs that "As soon as practicable after March 1, 1920, the Commission shall ascertain" the railway operating income factors going into the determination of the amount due. Section 204 (g) provides, "The Commission shall promptly certify to the Secretary of the Treasury the several amounts payable to carriers under paragraph (f). The Secretary of the Treasury is hereby authorized and directed *thereupon* to draw warrants in favor of each such carrier upon the Treasury of the United States for the amount shown in such certificate as payable thereto." (Italics added.) The amount therefore was not due, and could not be paid, until certified by the Commission. While in Section 209 (h) provision was made for advances on account of payments necessary to make good the *guaranty* provided for in that section, there was no provision for advances to carriers with claims under Section 204. The Secretary of the Treasury having refused to honor certificates for advances under Section 209 made by the Commission in favor of carriers who had not applied therefor during the guaranty period (see *Northern Pacific Railway Company* v. *Interstate Commerce Commission*, 23 F. (2d) 221, certiorari denied 275 U. S. 572), Congress, on February 26, 1921, added Section 212 to the Transportation Act (41 Stat. 1145). This provision for the first time enabled carriers claiming under Section 204 to obtain certificates for partial payment. Section 212 (a) provides in part:

> "In making certifications under section 204 or section 209, *the Commission, if not at the time able finally to determine the whole amount due* under such section to a carrier * * * may make its certificate for any amount definitely ascertained by it to be due * * *." (Italics added.)

Recognizing that the inability of the Commission at such time finally to determine the whole amount due did not arise out of failure to ascertain existing facts, Congress provided in Section 212 (b):

> "In ascertaining the several amounts payable under either of such sections, the Commission is authorized, in the case of deferred debits and credits which can not at the time be definitely determined, to make, whenever in its judgment practicable, a reasonable estimate of the net effect of any such items, and, *when agreed to by the carrier* or express company, to use such estimate as a definitely ascertained amount in certifying amounts payable under either of such sections and such estimates so agreed to shall be prima facie but not conclusive evidence of their correctness of amount in final settlement." (Italics added.)

If Congress had to recognize in 1921 that definite ascertainment of amounts due under Section 204 was still impossible, it is submitted that it was likewise impossible to the carriers in 1920. Nor can it be said that an estimate would do, since Congress in 1921 for the first time authorized the Commission to certify amounts due under Section 204 upon "a reasonable estimate" of the net effect of deferred debits and credits which could not at the time of the certification be definitely determined, and moreover that only when agreed to by the carrier. Even estimates so agreed to became only prima facie evidence of the correctness of their amount in final settlement.

Even as late as 1922, there was still a question as to what carriers came within the provisions of Section 204. 99 I. C. C. 724, overruling 66 I. C. C. 765.

Certifications of amounts due under Section 204 were expressly made conditional upon acceptance by the carrier of the amount so certified in final settlement of all its claims against the United States under that section. That the Cimarron and Northwestern Railway Company, like other carriers, so agreed (see *e. g.*, 71 I. C. C. 492, 823, 825, 853, 863) appears from the certificate of the Commission set out in paragraph 4 of the special findings of fact. Since the carrier could not resort to the courts for redress, it is evident that,

once the Commission had made up its mind as to the amount it would allow, the carrier, whether it agreed or not, had little choice but to accept. At any rate it could not obtain action from the Commission without accepting. It is submitted that a future right to the payment of an indefinite and undeterminable amount to be arrived at by agreement with the Interstate Commerce Commission can not be accrued until the agreement is reached.

3. *No determination of any amount payable was made by the Interstate Commerce Commission until 1923.*

On November 3, 1922, the Cimarron and Northwestern Railway Company furnished the information and data requested by the Commission in its form "Report of Deficit Roads under Section 204 of the Transportation Act of 1920." Thereafter a Commission accountant examined the Railway Company's accounts and determined a net credit in its favor under Section 204 of $42,594.76. The Bureau of Finance of the Interstate Commerce Commission then considered the matter and by letter dated April 12, 1923, notified the carrier that nothing was due, but gave leave "to submit additional data as to relative costs between the test period and the period of Federal control during which it operated its own road, this evidence to be considered in deriving a factor which might be applied to the carrier's claim and furnish a basis for its allowance." The result constituted "its exercise of a reasonable judgment upon consideration of all the relevant facts and circumstances," to make allowance, by the application of a factor, for differences between costs of labor and material for the test period and for the period of Federal control which "can not practicably be made upon the basis of any rigid rule or formula." See 70 I. C. C. 711, 714, *supra*. The additional data were furnished and on October 13, 1923, the Commission certified to the Secretary of the Treasury that the sum of $25,228.35 was payable under Section 204 (Finding 4, R. 13).

In its final decision the Interstate Commerce Commission, among other things, said:

"The carrier was under Federal control from January 1, 1918, to June 3, 1918, inclusive, and is entitled to the benefits of section 204 for the period from June 4, 1918, to February 29, 1920, inclusive. Its return under our circular of March 4, 1920, indicated a net credit of $45,090.57 in its favor for the period from January 1, 1918, to February 29, 1920, inclusive. Our examination of its accounts for the period from June 4, 1918, to February 29, 1920, inclusive, shows the net credit to the carrier for that period to be $42,594.76 before making the adjustments under the provisions of paragraph (f) of section 209, required by paragraph (b) of section 204.

"Consideration has been given by us to the adjustment of maintenance charges and applying, so far as practicable, the rule set forth in the proviso of paragraph (a) of section 5 of the standard contract between the director general and carriers under Federal control, we have disallowed $17,366.41 of the maintenance expenditures for the period in question." (Finding 4, R. 14.)

Thus it appears conclusively from the record that no determination of any amount payable was either tentatively or finally made until in 1923 and, furthermore, as shown in the second proposition above, that no such determination was possible until the Interstate Commerce Commission made "the adjustments under the provisions of paragraph (f) of section 209, required by paragraph (b) of section 204," in accordance with the general formula first announced in December, 1921. 70 I. C. C. 711, 714–715.

If the Cimarron and Northwestern Railway Company had been compelled to accrue for income tax purposes in 1920 an amount due it under Section 204, it would have had to accrue the amount claimed in its return on November 3, 1922, whereas the amount finally determined in 1923 was $25,228.35. While the amount claimed of $45,090.57 was reasonably close to the amount of $42,594.76 found by the Commission to be due before making the all-important adjustments of maintenance charges, etc. under paragraph (f) of Section 209, the amount claimed exceeded the amount finally allowed by more than 75 per cent. This is not the reasonably close estimate which the Court of Claims assumed the carrier to be able to make for the purpose of accrual in 1920. The very findings of the Court

of Claims (Finding 4) disclose its error in stating that "There appears to have been no substantial dispute between the plaintiff and the Interstate Commerce Commission as to its claim." Nor is it correct to say that the delay in the payment of the plaintiff's claim was due to the failure of the plaintiff to report the facts to the Commission, for, as is shown above, the Commission itself had not determined the basis of computation of the amount due until a later year.

In view of the controversy between the Commission and the carriers with regard to the adjustments of maintenance and other expenses required by Section 209 and the inability of carriers to obtain any amount in final settlement except upon agreement with the Commission, the situation is like that involved in *Lucas* v. *American Code Company, Inc.*, 280 U. S. 445. That case is distinguished by the Court of Claims on the ground that the plaintiff in that case was not a common carrier subject to interstate commerce regulations which prescribed its method of accounting. It has already been pointed out that in its determination of railway operating income the Commission departed from the regular accounting methods prescribed by it. The classifications of accounts of the Commission require the adjustment in later years of entries made in the particular year so as to reflect the actual outcome of transactions as to which there could be nothing but estimates on the books in the earlier year. Such a method of bookkeeping, while approaching an ideal of exactness, is entirely impracticable in the administration of the Revenue Acts. These require the determination of income by taxpayers annually, on the basis of data available to them. The crucial point which the Court of Claims thus failed to regard is the practical one stated at this term by Mr. Justice Butler in *United States Cartridge Co.* v. *United States*, 52 S. Ct. 243, 246-247:

> "The tax laws are calculated to produce revenue ascertainable and payable at regular intervals. Otherwise it would not be practicable to devise methods of accounting, assessment or collection capable of operation. Burnet *v.* Sanford & Brooks Co., 282 U. S. 359, 365."

To require the returns to be adjusted on the basis of information which in the nature of things can not be obtained until a much later date (when statutes of limitations may have run) is not only impracticable but, we submit, contrary to the plain intent of Congress. We believe that it was for this reason that this Court said at this term in *Old Colony R. R. Co.* v. *Commissioner*, 52 S. Ct. 211, by Mr. Justice Roberts (p. 214):

> "Moreover, the rules of accounting enforced upon a carrier by the Interstate Commerce Commission are not binding upon the Commissioner; nor may he resort to the rules of that body, made for other purposes, for the determination of tax liability under the revenue acts."

The case of *Burnet* v. *Sanford & Brooks Company*, 282 U. S. 359, affords a close parallel to the case at bar. In that case the taxpayer had received in 1920, pursuant to judgment against the United States, an amount compensatory of the cost of work done by the taxpayer in the years 1913 to 1916, the expenses of which had been deducted in the returns for those years. The Circuit Court of Appeals held, reversing an order of the Board of Tax Appeals, that the amount received in 1920 was not income, but it conditioned the reversal upon the filing by the taxpayer of amended returns for the years 1913 to 1916, from which were to be omitted the deductions of the related items of expenses paid in those years. This Court reversed the judgment. The decision clearly shows that the accrual basis of making income tax returns does not require that all items of income be reported in the return for the year to which they relate, but that there was a "practical necessity of computing the tax on the basis of annual or other fixed taxable periods, which might result in the taxpayer being required to pay a tax on income in one period exceeded by net losses in another." The petitioner's return for 1920 was therefore in accordance with law, although it did not report the amount paid by the United States in 1923, pursuant to a quasi-judicial finding by the Interstate Commerce Commission under a statute enacted in 1920. The test is not to what year the item relates, but in what year the events occur which enable its amount to be fixed.

It is submitted, on the grounds heretofore stated, that in the case at bar the events which enabled the amount of the payment to be fixed had not occurred in 1920, and the amount could therefore not be accrued. *Cf. United States* v. *Anderson*, 269 U. S. 422, 441. In that case all the events had occurred, at the close of the taxable year from which the munitions tax could be precisely determined, under a formula involving no adjustment in later years of entries, recording the events of the taxable year, made in accordance with the regular accrual method of bookkeeping practiced by the taxpayer. In the case at bar the formula for determining the payment to be made under Section 204 involved the exercise of discretion, as to facts to be considered and adjustments of prices and expenses to be made, by an independent body whose judgment was apparently uncontrolled by the judiciary. The calculation of the munitions tax for the year 1916 involved in the *Anderson* case could be made by the taxpayer itself at the end of that year on the basis of facts established during the year. The calculation of payments under Section 204 or Section 209 of the Transportation Act could not be made by the carrier at the end of the year 1920 on the basis of facts established during that year. Nothing that happened after the end of the year 1916 could affect the liability for munitions tax for that year. On the other hand, payments under Section 204 or Section 209 of the Transportation Act were conditioned on events that did not happen in 1920 and, in view of the complexity of the questions to be decided before the necessary discretion by the Interstate Commerce Commission could be exercised, could not have happened in 1920.

It is submitted, therefore, that the apparently unenforceable obligation of the United States to pay an amount to be determined by the Interstate Commerce Commission in accordance with discretionary principles not announced by it during 1920, payment of which was obtainable only upon action by the Commission apparently uncontrolled by the courts and only upon agreement by the carrier not to claim more, could not be accrued for income tax purposes in the year 1920. To do so would be to postpone the assessment of the tax for 1920 for an indefinite period, in order to ascertain more precisely

the final outcome of the period, and to depart from the annual basis of income taxation which all the revenue acts have adopted. *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 365.

VII. CONCLUSION.

In view of the foregoing it is respectfully submitted that this Honorable Court should reverse and set aside the decision and judgment of the Court of Claims so far as it pertains to the item of $25,228.35 which was paid to the Cimarron and Northwestern Railway Company in 1923 under the provisions of Section 204 of the Transportation Act of 1920, and hold that such payment did not constitute taxable income to the recipient or, if it was taxable income, that it was returnable in the year 1923 when the amount was determined and paid.

Respectfully submitted,

GEO. E. H. GOODNER,
Attorney for Petitioner,
Munsey Building,
Washington, D. C.

JOHN G. BUCHANAN,
PAUL G. RODEWALD,
Of Counsel.

APPENDIX.

Excerpts from the Revenue Act of 1918:

"SEC. 213. That for the purposes of this title * * * the term 'gross income'—

"(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of Section 212, any such amounts are to be properly accounted for as of a different period; but

"(b) Does not include the following items, which shall be exempt from taxation under this title:

* * * * * * * * *

"(3) The value of property acquired by gift, bequest, devise or descent (but the income from such property shall be included in gross income); * * *."

Excerpts from the Transportation Act of 1920:

"SEC. 204. (a) When used in this section—

"The term 'carrier' means a carrier by railroad which, during any part of the period of Federal control, engaged as a common carrier in general transportation, and competed for traffic, or connected, with a railroad under Federal control, and which sustained a deficit in its railway operating income for that portion (as a whole) of the period of Federal control during which it operated its own railroad or system of transportation; but does not include any street or interurban electric railway which has as its principal source of operating revenue urban, suburban, or interurban passenger traffic or sale of power, heat, and light, or both; and

"The term 'test period' means the three years ending June 30, 1917.

"(b) For the purposes of this section—

"Railway operating income or any deficit therein for the period of Federal control shall be computed in a manner similar to that provided in section 209 with respect to such income or deficit for the guaranty period; and

"Railway operating income or any deficit therein for the test period shall be computed in the manner provided in section 1 of the Federal Control Act.

"(c) As soon as practicable after March 1, 1920, the Commission shall ascertain for every carrier, for every month of the period of Federal control during which its railroad or system of transportation was not under Federal operation, its deficit in railway operating income, if any, and its railway operating income, if any (hereinafter called 'Federal control return'), and the average of its deficit in railway operating income, if any, and of its railway operating income, if any, for the three corresponding months of the test period taken together (hereinafter called 'test period return'): *Provided*, That 'test period return' in the case of a carrier which operated its railroad or system of transportation for at least one year during, but not for the whole of, the test period, means its railway operating income, or the deficit therein, for the corresponding month during the test period, or the average thereof for the corresponding months during the test period taken together, during which the carrier operated its railroad or system of transportation.

"(d) For every month of the period of Federal control during which the railroad or system of transportation of the carrier was not under Federal operation, the Commission shall then ascertain (1) the difference between its Federal control return, if a deficit, and its test period return, if a smaller deficit, or (2) the difference between its test period return, if an income, and its Federal control return, if a smaller income, or (3) the sum of its Federal control return, if a deficit, plus its test period return, if an income. The sum of such amounts shall be credited to the carrier.

"(e) For every such month the Commission shall then ascertain (1) the difference between the carrier's Federal control return, if an income and its test period return, if a smaller income, or (2) the difference between its test period return, if a deficit, and its Federal control return, if a smaller deficit, or (3) the sum of its Federal control return, if an income, plus its test period return, if a deficit. The sum of such amounts shall be credited to the United States.

"(f) If the sum of the amounts so credited to the carrier under subdivision (d) exceeds the sum of the amounts so credited to the United States under subdivision (e), the difference shall be payable to the carrier. In the case of a carrier which operated its railroad or system of transportation for less than a year during, or for none of, the test period, the foregoing computations shall not be used, but there shall be payable to such carrier its deficit in railway operating income for that portion (as a whole) of the period of Federal control during which it operated its own railroad or system of transportation.

"(g) The Commission shall promptly certify to the Secretary of the Treasury the several amounts payable to carriers under paragraph (f). The Secretary of the Treasury is hereby authorized and directed thereupon to draw warrants in favor of each such carrier upon the Treasury of the United States for the amount shown in such certificate as payable thereto. An amount sufficient to pay such warrants is hereby appropriated out of any money in the Treasury not otherwise appropriated."

SEC. 209. (a) When used in this section—

The term "carrier" means (1) a carrier by railroad or partly by railroad and partly by water, whose railroad or system of transportation is under Federal control at the time Federal control terminates, or which has heretofore engaged as a common carrier in general transportation and competed for traffic, or connected, with a railroad at any time under Federal control; and (2) a sleeping car company whose system of transportation is under Federal control at the time Federal control terminates; but does not include a street or interurban electric railway not under Federal control at the time Federal control terminates, which has as its principal source of operating revenue urban, suburban, or interurban passenger traffic or sale of power, heat, and light, or both;

The term "guaranty period" means the six months beginning March 1, 1920.

The term "test period" means the three years ending June 30, 1917; and

The term "railway operating income" and other references to accounts of carriers by railroad shall, in the case of a sleeping car company, be construed as indicating the appropriate corresponding accounts in the accounting system prescribed by the Commission.

(b) This section shall not be applicable to any carrier which

does not on or before March 15, 1920, file with the Commission a written statement that it accepts all the provisions of this section.

(c) The United States hereby guarantees—

(1) With respect to any carrier with which a contract (exclusive of so-called cooperative contracts or waivers) has been made fixing the amount of just compensation under the Federal Control Act, that the railway operating income of such carrier for the guaranty period as a whole shall not be less than one-half the amount named in such contract as annual compensation or, where the contract fixed a lump sum as compensation for the whole period of Federal operation, that the railway operating income of such carrier for the guaranty period as a whole shall not be less than an amount which shall bear the same proportion to the lump sum so fixed as six months bears to the number of months during which such carrier was under Federal operation, including in both cases the increases in such compensation provided for in section 4 of the Federal Control Act;

(2) With respect to any carrier entitled to just compensation under the Federal Control Act, with which such a contract has not been made, that the railway operating income of such carrier for the guaranty period as a whole shall not be less than one-half of the annual amount estimated by the President as just compensation for such carrier under the Federal Control Act, including the increases in such compensation provided for in section 4 of the Federal Control Act. If any such carrier does not accept the President's estimate respecting its just compensation, and if, in proceedings under section 3 of the Federal Control Act it is determined that a larger or smaller annual amount is due as just compensation, the guaranty under this paragraph shall be increased or decreased accordingly;

(3) With respect to any carrier, whether or not entitled to just compensation under the Federal Control Act, with which such a contract has not been made, and for which no estimate of just compensation is made by the President, and which for the test period as a whole sustained a deficit in railway operating income, the guaranty shall be a sum equal to (a) the amount by which any deficit in its railway operating income for the guaranty period as a whole exceeds one-half of its average annual deficit in railway operating income for the test period, plus (b) an amount equal to one-half the annual sum fixed by the President under section 4 of the Federal Control Act;

(4) With respect to any carrier not entitled to just com-

pensation under the Federal Control Act, which for the test period as a whole had an average annual railway operating income, that the railway operating income of such carrier for the guaranty period as a whole shall not be less than one-half the average annual railway operating income of such carrier during the test period.

(d) If for the guaranty period as a whole the railway operating income of any carrier entitled to a guaranty under paragraph (1), (2), or (4) of subdivision (c) is in excess of the minimum railway operating income guaranteed in such paragraph, such carrier shall forthwith pay the amount of such excess into the Treasury of the United States. If for the guaranty period as a whole the railway operating income of any carrier entitled to a guaranty under paragraph (3) of subdivision (c) is in excess of one-half of the annual sum fixed by the President with respect to such carrier under section 4 of the Federal Control Act, such carrier shall forthwith pay the amount of such excess into the Treasury of the United States. The amounts so paid into the Treasury of the United States shall be added to the funds made available under section 202 for the purposes indicated in such section. Nothwithstanding the provisions of this subdivision, any carrier may retain out of any such excess any amount necessary to enable it to pay its fixed charges accruing during the guaranty period.

(e) For the purposes of this section railway operating income, or any deficit therein, for the test period shall be computed in the manner provided for in section 1 of the Federal Control Act.

(f) In computing railway operating income, or any deficit therein, for the guaranty period for the purposes of this section—

(1) Debits and credits arising from the accounts, called in the monthly reports to the Commission equipment rents and joint facility rents, shall be included, but debits and credits arising from the operation of such street electric passenger railways, including railways commonly called interurbans, as are not under Federal control at the time of termination thereof, shall be excluded;

(2) Proper adjustments shall be made (a) in case any lines which were, during any portion of the period of Federal control, a part of the railroad or system of transportation of the carrier, and whose railway operating income was included in such income of the carrier for the test period, do not continue to be a part of such railroad or system of transportation during the entire guaranty period, and (b) in case of any lines acquired by, leased to, or consolidated with, the railroad or system of

transportation of the carrier at any time since the end of the test period and prior to the expiration of the guaranty period, for which separate operating returns to the Commission are not made in respect to the entire portion of the guaranty period;

(3) There shall not be included in operating expenses, for maintenance of way and structures, or for maintenance of equipment, more than an amount fixed by the Commission. In fixing such amount the Commission shall so far as practicable apply the rule set forth in the proviso in paragraph (a) of section 5 of the "standard contract" between the United States and the carriers (whether or not such contract has been entered into with the carrier whose railway operating income is being computed);

(4) There shall not be included any taxes paid under Title I or II of the Revenue Act of 1917, or such portion of the taxes paid under Title II or III of the Revenue Act of 1918 as by the terms of such Act are to be treated as levied by an Act in amendment of Title I or II of the Revenue Act of 1917; and

(5) The Commission shall require the elimination and restatement of the operating expenses and revenues (other than for maintenance of way and structures, or maintenance of equipment) for the guaranty period, to the extent necessary to correct and exclude any disproportionate or unreasonable charge to such expenses or revenues for such period, or any charge to such expenses or revenues for such period which under a proper system of accounting is attributable to another period.

(g) The Commission shall, as soon as practicable after the expiration of the guaranty period, ascertain and certify to the Secretary of the Treasury the several amounts necessary to make good the foregoing guaranty to each carrier. The Secretary of the Treasury is hereby authorized and directed thereupon to draw warrants in favor of each such carrier upon the Treasury of the United States, for the amount shown in such certificate as necessary to make good such guaranty. An amount sufficient to pay such warrants is hereby appropriated out of any money in the Treasury not otherwise appropriated.

(h) Upon application of any carrier to the Commission, asking that during the guaranty period there may be advanced to it from time to time such sums, not in excess of the estimated amount necessary to make good the guaranty, as are necessary to enable it to meet its fixed charges and operating expenses, the Commission may certify to the Secretary of the Treasury the amount of, and times at which, such advances, if any, shall be made. The Secretary of the Treasury, on receipt of

such certificate, is authorized and directed to make the advances in the amounts and at the times specified in the certificate, upon the execution by the carrier of a contract, secured in such manner as the Secretary may determine, that upon final determination of the amount of the guaranty provided for by this section such carrier will repay to the United States any amounts which it has received from such advances in excess of the guaranty, with interest at the rate of 6 per centum per annum from the time such excess was paid. There is hereby appropriated, out of any money in the Treasury not otherwise appropriated, a sum sufficient to enable the Secretary of the Treasury to make the advances referred to in this subdivision.

Amendment to the Transportation Act of 1920 (enacted February 26, 1921).

"SEC. 212. (a) In making certifications under section 204 or section 209, the Commission, if not at the time able finally to determine the whole amount due under such section to a carrier or the American Railway Express Company, may make its certificate for any amount definitely ascertained by it to be due, and may thereafter in the same manner make further certificates, until the whole amount due has been certified. The authority of and direction to the Secretary of the Treasury under such sections to draw warrants is hereby made applicable to each such certificate. Warrants drawn pursuant to this section, whether in partial payment or in final payment, shall be paid: (1) If for a payment in respect to reimbursement of a carrier for a deficit during the period of Federal control, out of the appropriation made by section 204; (2) If for a payment in respect to the guaranty to a carrier other than the American Railway Express Company, out of the appropriation made by subdivision (g) of section 209; and (3) if for a payment in respect to the guaranty to the American Railway Express Company, out of the appropriation made by the fifth paragraph of subdivision (i) of section 209.

"(b) In ascertaining the several amounts payable under either of such sections, the Commission is authorized, in the case of deferred debits and credits which can not at the time be definitely determined, to make, whenever in its judgment practicable, a reasonable estimate of the net effect of any such items, and, when agreed to by the carrier or express company, to use such estimate as a definitely ascertained amount in certifying amounts payable under either of such sections, and such estimates so agreed to shall be prima facie but not conclusive evidence of their correctness in amount in final settlement."

FILE COPY

Office Supreme Court
FILED
JAN 23 19
CHARLES ELMORE

No. 560

In the Supreme Court of the United States

OCTOBER TERM, 1931

CONTINENTAL TIE AND LUMBER COMPANY,
PETITIONER

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

MEMORANDUM FOR THE UNITED STATES

INDEX

	Page
Opinion below	1
Jurisdiction	1
Questions presented	2
Statutes involved	2
Statement	2
Discussion	3

CITATIONS

Cases:	
Edwards v. *Cuba Railroad*, 268 U. S. 628	4
Gulf, Mobile & Northern R. R. Co. v. *Commissioner*, 22 B. T. A. 233	4
Texas & Pacific Ry. Co. v. *United States*, No. 634, October term, 1931	3, 4
Williams v. *Heard*, 140 U. S. 529	4

In the Supreme Court of the United States

OCTOBER TERM, 1931

No. 560

CONTINENTAL TIE AND LUMBER COMPANY, PETITIONER

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

MEMORANDUM FOR THE UNITED STATES

We do not oppose the instant petition.

OPINION BELOW

The opinion of the Court of Claims (R. 15) is reported in 52 F. (2d) 1045.

JURISDICTION

The judgment sought to be reviewed was entered on October 20, 1931. (R. 21.) The petition for certiorari was filed on December 8, 1931. (R. 22.) The jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925.

97445—32

QUESTIONS PRESENTED

1. Whether a sum paid the petitioner as reimbursement of its railway operating deficit for the period during which other railroads were under Federal control, pursuant to a certificate of the Interstate Commerce Commission issued under Section 204 of the Transportation Act of 1920, was taxable income.

2. Whether, if it was such income, it was taxable, as the Commissioner ruled, in 1920 when the Act was passed, rather than in 1923 when the certificate was issued.

STATUTES INVOLVED

The statutes involved are set forth in the Appendix to petitioner's brief, pp. 11–12.

STATEMENT

The petitioner filed a consolidated tax return for 1920 on the accrual basis, on behalf of itself and the Cimarron & Northwestern Railway Company, and during 1921 paid the tax so reported. (R. 12.) In considering and allowing a claim for refu d of part of this tax, the Commissioner added to the petitioner's 1920 income $27,228.35, thus reducing the refund paid. (R. 12.)

The amount of the tax ($200) on $2,000 of the increase was decided by the Court of Claims to be due the petitioner as a refund, and the Government does not question that decision.

The rest of the increase made by the Commissioner in 1920 income, $25,228.35, was attributable to an amount paid the petitioner in October, 1923, pursuant to a certificate of the Interstate Commerce Commission acting under Section 204 of the Transportation Act of 1920, which provided for the reimbursement of certain carriers for railway operating deficits during the period in which other railroads were under Federal control. (R. 12, 13.) No question is raised as to the correctness of the certificate. The petitioner's claim for refund of the tax was duly filed and rejected by the Commissioner. The Court of Claims allowed no recovery on account on this item.

DISCUSSION

The instant case is apparently the first case in which the precise point here involved has been decided. The other cases in which it is presented are not numerous nor do they involve large amounts. But the question is similar to that which is presented in cases of railroads which, under Section 209 of the Transportation Act of 1920, received payments from the Government for the "guaranty period" of six months beginning March 1, 1920. A petition for certiorari to the Court of Claims in such a case has recently been filed. *Texas & Pacific Railway Co.* v. *United States,* No. 634. The only decisions as to the taxability of funds paid

under Section 209 are that of the Court of Claims in that case and those of the Board of Tax Appeals in *Gulf, Mobile & Northern Railroad Co.* v. *Commissioner,* 22 B. T. A. 233, and other cases, all of which held such payments taxable. The Government will not oppose the petition in the *Texas & Pacific Railway Co.* case, as the question there presented seems to be one of importance. There are now pending in the Board of Tax Appeals sixteen cases involving that question, in addition to two cases in the United States District Court. The amounts involved in these cases aggregate more than $11,000,000, and it seems highly probable that appeals in these cases will be taken to the Circuit Courts of Appeals of nearly all of the circuits.

The taxpayers in the instant case and in the cases arising under Section 209 assert that the decisions of the Court of Claims are in conflict with that of this Court in *Edwards* v. *Cuba Railroad,* 268 U. S. 628. We do not agree with this assertion, and believe that both cases were correctly decided by the Court of Claims. Nevertheless, there seems to be no controlling decision by this Court. See, however, *Williams* v. *Heard,* 140 U. S. 529.

In this situation we believe that much litigation and expense will be avoided if questions arising in regard to payments made under both Sections 204 and 209 are now settled by this Court.

For these reasons, we do not oppose the instant petition.

Respectfully submitted.

THOMAS D. THACHER,
Solicitor General.
CHARLES B. RUGG,
Assistant Attorney General.
CLAUDE R. BRANCH,
Special Assistant to the Attorney General.
LISLE A. SMITH,
BRADLEY B. GILMAN,
Attorneys.

JANUARY, 1932.

U. S. GOVERNMENT PRINTING OFFICE: 1932

Office Supreme Court
FILED
APR 9 19
CHARLES ELMORE
C

FILE COPY

No. 560

In the Supreme Court of the United States

OCTOBER TERM, 1931

CONTINENTAL TIE AND LUMBER COMPANY, PETITIONER

v.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

INDEX

	Page
Opinion below	1
Jurisdiction	1
Questions presented	2
Statutes involved	2
Statement	2
Summary of argument	3
Argument:	
I. The payment constituted income to the petitioner	5
II. The payment was income for the year 1920	8
Conclusion	16
Appendix (Statutes involved)	17–20

CITATIONS

Cases:	
Cimarron and Northwestern Railway Company, 82 I. C. C. 441	14
Commissioner v. *Old Dominion S. S. Company*, 47 F. (2d) 148	10
Construction of the word "Deficit," 66 I. C. C. 765	5
Duquesne Steel Foundry Co. v. *Commissioner*, 283 U. S. 799	12
Fawcus Machine Co. v. *United States*, 282 U. S. 375	11, 12
Galveston Wharf Company v. *Commissioner*, 22 B. T. A. 1312	13
Great Northern Railway Co. v. *United States*, 277 U. S. 172	9
Little Cottonwood Transportation Co., 65 I. C. C. 189	11
Lucas v. *American Code Co.*, 280 U. S. 445	10
Marion & Rye Valley Railway Company v. *United States*, 60 C. Cls. 230, affirmed, 270 U. S. 280	5
Norfolk Southern Railroad Co., 65 I. C. C. 798	15
Texas & Pacific Railway Co. v. *United States*, No. 634, October Term, 1931	3, 4
Williamsport Wire Rope Co. v. *United States*, 277 U. S. 551	12
Statutes:	
Federal Control Act, 1918, c. 25, 40 Stat. 451	5
Revenue Act of 1918, c. 18, 40 Stat. 1057, 1065, 1093	12
Section 213	17
Section 327	12
Section 328	12
Transportation Act, 1920, c. 91, 41 Stat. 456, 460, 464	17
Sec. 204 (U. S. C., Title 49, sec. 73)	17
Sec. 209 (U. S. C., Title 49, sec. 77)	15
Sec. 212 (c. 72, 41 Stat. 1145, U. S. C., Title 49, sec. 79)	7, 15
Miscellaneous:	
C. B. I–1, I. T., 1326, p. 91	8
C. B. IV–1, S. M. 2970, p. 127	10
C. B. IV–2, S. M. 4236, p. 149	8, 13
Report of Director General of Railroads, 1924, pp. 36, 37	6

In the Supreme Court of the United States

OCTOBER TERM, 1931

No. 560

CONTINENTAL TIE AND LUMBER COMPANY, petitioner

v.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

OPINION BELOW

The opinion of the Court of Claims (R. 15) is reported in 52 F. (2d) 1045.

JURISDICTION

The judgment sought to be reviewed was entered October 20, 1931. (R. 21.) The petition for certiorari was filed December 8, 1931, and the writ was granted February 15, 1932. (R. 22, 23.) The jurisdiction of this Court rests on Section 3 (b) of the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether a sum paid the petitioner as reimbursement of its railway-operating deficit for the period during which other railroads were under Federal control, pursuant to a certificate of the Interstate Commerce Commission issued under Section 204 of the Transportation Act, 1920, was taxable income.

2. Whether, if it was such income, it was taxable, as the Commissioner ruled, in 1920 when the Act was passed, rather than in 1923 when the certificate was issued.

STATUTES INVOLVED

The statutes involved are set forth in the Appendix, *infra*, pp. 17–20.

STATEMENT

The petitioner filed a consolidated tax return for 1920 on the accrual basis, on behalf of itself and the Cimarron & Northwestern Railway Company, and during 1921 paid the tax so reported. (R. 12.) In considering and allowing a claim for refund of part of this tax, the Commissioner added to the consolidated 1920 income $27,228.35, thus reducing the refund paid. (R. 12.)

The amount of the tax paid as to $2,000 of the increase was decided by the Court of Claims to be due the petitioner as a refund, and the Government does not question that decision.

The rest of the increase made by the Commissioner to 1920 income, $25,228.35, was attributable

to an amount paid the Cimarron & Northwestern Railway Company in October, 1923, pursuant to a certificate of the Interstate Commerce Commission acting under Section 204 of the Transportation Act, 1920, which provided for the reimbursement of certain carriers for railway operating deficits during the period in which other railroads were under Federal control. (R. 12, 13.) No question is raised as to the correctness of the certificate. The petitioner's claim for refund of the tax was duly filed and rejected by the Commissioner. The Court of Claims allowed no recovery on account of this item.

SUMMARY OF ARGUMENT

The payment made under Section 204 of the Transportation Act, 1920, constituted income to the petitioner, a short-line railroad. The Government's moral obligation to make such reimbursement was generally recognized. Like the similar guaranty payments to the trunk lines under Section 209, discussed in No. 634, *The Texas & Pacific Railway Company* v. *United States*, these sums were intended as compensation to the carriers, and were not considered gratuities by Congress. To hold those amounts tax-exempt would place the carrier with a low operating revenue during the Federal control period in a better position than that occupied by the stronger short line which had no deficit. Congress intended no such anomalous result.

The payment under Section 204 was income for the year 1920. The petitioner's books were on the accrual basis. The obligation to pay the carrier became a legal liability upon the passage of the Act in 1920. The petitioner, under the practice of the Bureau of Internal Revenue, should have accrued the gross amount less estimated deductions during 1920 when it was requested by the Interstate Commerce Commission to file a report of its deficit. The fact that the Commission was required to calculate the exact amount of these deductions is not significant since the liability was already certain. It was possible for short lines, like the petitioner's, to secure payment under Section 204 during the year 1920 by filing their reports promptly. That the reimbursement in the instant case was not certified by the Commission until after 1920 was due to the tardy action of the petitioner.

ARGUMENT

This case follows No. 634, *The Texas & Pacific Railway Company* v. *United States*, a similar case, but one where the payments were made under Section 209 of the Transportation Act, 1920. As much of the argument by the Government in No. 634 is applicable also to the instant case, we respectfully refer the Court to our Brief in that case, and to avoid repetition present in this Brief only certain additional discussion which, not pertinent to No. 634 is of importance in the instant case.

I

THE PAYMENT CONSTITUTED INCOME TO THE PETITIONER

Section 204 of the Transportation Act, 1920 (*infra* p. 17), provided for compensation to certain short lines, which while under private operation had suffered loss because other roads were under Federal control. In effect railroads which had not been under Federal control during the entire period were to be paid the difference between the average pro-rata earnings during the interval of Federal control when the particular road was under private management, and the average earnings during three years next prior to the Federal control period. This latter period is called the "test period." The difference is designated in Section 204 (a) as a "deficit." This has been interpreted to mean the difference between the earnings during the Federal control period and the average earnings of the "test period." *Construction of the word "Deficit,"* 66 I. C. C. 765.

The lines referred to in Section 204 suffered by the Government regulation of trunk roads with which they connected, and by the routing of freight over competing through lines which were under Federal control. The Federal Control Act of 1918, c. 25, 40 Stat. 451, did not provide for compensation to such short lines which were not taken over by the Government. *Marion & Rye Valley Railway Company* v. *United States,* 60 C. Cls. 230, 253, affirmed, 270 U. S. 280. The petitioner was under Federal control for six months and has been fully compen-

sated for that use of its road. (R. 12.) Under Section 204 of the 1920 Act it received a further payment which was intended to supplement the compensation received by it under the Federal Control Act. This purpose was recognized by the court below when it stated (R. 19):

> the specific purpose of the section was to reimburse such railways on account of deficits in their net railway operating income. The legislative history shows that it was the intention of Congress to extend certain aid to railways not under Federal control consisting largely of so-called short lines, in recognition not only of their financial necessities but of injury to them through Federal control and operation of lines with which they connected or competed during the Federal control period.

That the Government's liability to reimburse the short lines was generally recognized is indicated by the following quotation from the 1924 Report of the Director General of Railroads, pages 36, 37:

> It was quite evident that there was an ultimate liability of some sort to these short lines on the part of the Government for the entire period of Federal control, and that this liability must be liquidated either by the Interstate Commerce Commission, under the provisions of the deficit section (204, transportation act), or the Railroad Administration, on the theory that these properties were at least under nominal Federal control for the first six months of that period.

It is evident from the phraseology of Section 204 that Congress was not contemplating a gratuity in the sense of a gift unsupported by any obligation. The title of Section 204 "Reimbursement of Deficits during Federal Control" and the characterization in Section 212 (Act of February 26, 1921, c. 72, 41 Stat. 1145, U. S. C., Title 49, Sec. 79) of the payments under Section 204 as reimbursements to carriers indicate that Congress intended payment of compensation and satisfaction of a moral obligation, rather than a gift.

Moreover, the nontaxability of these payments under Section 204 would be inconsistent with the purpose of the statute. Congress desired to restore the competitive balance of the railroads which had existed prior to Federal control. It sought to strengthen the carriers which had been injured by Federal control so that they would be placed in the same relative position they had occupied prior to Federal control. There was no purpose to place the weaker roads which Congress was reimbursing in a better position than the stronger short lines which received no payment under Section 204. Yet that is what would happen if these payments should be held tax exempt.

Thus, assume that short-line carrier "A" during Federal control earned $200,000, and that the operation of short-line "B," similarly placed, resulted in larger earnings of $500,000. Both roads during the test period had an income of $500,000. Road "B" will, of course, be taxed upon its $500,000 oper-

ating revenue. Road "A" will receive a Government payment of $300,000 tax-free and as a result be better situated financially than its competitor. Such an unreasonable result was not intended by Congress in passing Section 204. To hold the payments taxable income would result in no such unfair discrimination in favor of the weaker roads.

At all times the Treasury Department has held that payments under Section 204 of the Transportation Act were taxable income. The Commissioner first ruled that they were income for the taxable year in which the deficit was sustained. I. T. 1326, I–1, C. B., 91. This was changed by S. M. 4236, IV–2, C. B. 149, in which the question was considered at length and such payments held to be income for 1920, the year in which the right to the reimbursement arose.

II

THE PAYMENT WAS INCOME FOR THE YEAR 1920

The petitioner contends that even if the payment of the operating deficit under the provisions of Section 204 of the Transportation Act was taxable income to the railroad, nevertheless it should be taxed in the year 1923 when the Interstate Commerce Commission determined the amount due and certified it to the Treasury for payment. The Cimarron and Northwestern Railway kept its books on the accrued basis. (R. 15.)

Section 204 created an obligation on the part of the Government to reimburse the so-called short line railroads for their operating deficit during the

period of Federal control. The liability of the Government to pay was unqualified. The method of computation of the amount of reimbursement was detailed in the Act. In general the Act directs the Interstate Commerce Commission to ascertain the amount of reimbursement by a comparison of the operating revenue of the railroad for the period of Federal control with its corresponding average revenue during the test period which preceded Federal control. The actual calculation and comparison of the income for these two periods predicated upon reports from the railroads was left to the Commission. See *Great Northern Railway Co.* v. *United States,* 277 U. S. 172, 180.

Upon the passage of the Act payment was certain. The maximum limit of reimbursement was definitely fixed by the terms of the statute. The railroad could have ascertained its gross claim with accuracy from its own books while awaiting the decision of the Interstate Commerce Commission. The payment of this was assured, after deductions in the reconciliation of the revenue during the two periods had been made.

The positive assurance of the payment of the deficit to it upon the passage of the Transportation Act, 1920, resulted in the accrual at that time of the amount ultimately received. Certainly the taxpayer by the end of 1920 could have accrued the gross amount reported less estimated deductions and then have corrected those deductions by an amended return after the Commission's determina-

tion. Such procedure was authorized by the Commissioner of Internal Revenue. See S. M. 2970, IV–1 C. B. 127. The statute fixed liability and all that remained to be determined after the passage of the Act was the amount of the difference of operating costs and expenses based on the past facts within the knowledge of the carrier. In *Commissioner* v. *Old Dominion S. S. Company,* 47 F. (2d) 148 (C. C. A. 2d), it was held in a similar case that payments under the Federal Control Act of the excess over the standard return due the carrier accrued prior to payment.

Although there was vested in the Interstate Commerce Commission some latitude in the determination of the deficit as defined in the statute, the Commission was bound to adjust the accounts and ascertain the amount of reimbursement under settled principles of railway accounting. Although the amount was not liquidated until the Commission finally certified the sum payable, there was no litigation or dispute as to the right of recovery. See *Lucas* v. *American Code Co.,* 280 U. S. 445, where the accrual of a loss prior to the date on which *liability* was certain was denied. Moreover in the instant case the approximate amount of the payment was predictable and the maximum limit was definitely ascertainable.

It was possible for the Cimarron & Northwestern Railway Company to have accelerated the consideration of its claim by the Commission so as to have received the reimbursement during the year 1920. For example, the Little Cottonwood Trans-

portation Company by filing its return promptly instead of delaying until 1922, as was done in the instant case, received its payment under Section 204 in 1920. *Little Cottonwood Transportation Co.*, 65 I. C. C. 189. The despatch with which the Commission acted in these cases once the carrier's report was filed is indicated by this last cited matter. The Little Cottonwood Transportation Company, in response to the Commission's circular of March 4, 1920, filed its return promptly. The case was submitted to the Commission on July 6, 1920, and decided on September 18, 1920, when the certificate to the Secretary of the Treasury was issued.

In *Fawcus Machine Co.* v. *United States,* 282 U. S. 375, this Court held that the invested capital of a corporate taxpayer on an accrual basis should be reduced in its return for 1919 by the amount of 1918 taxes, although those taxes were not ascertainable until February 24, 1919, when the Revenue Act of 1918 was passed. In determining such questions of accrual, the important fact to be ascertained is the date on which liability concededly becomes fixed.

The rule of the *Fawcus Machine Company* case in approving the validity of Article 845 of Treasury Regulations 45 (providing that "federal income taxes are deemed to have been paid out of net income of the taxable year for which they are levied") is equally applicable to cases in which excess profits taxes for the year 1918 are assessed under the provisions relative to special assessments.

(Secs. 327–328, Revenue Act of 1918, c. 18, 40 Stat. 1057, 1093.) The Bureau of Internal Revenue has consistently construed this section of the regulations as accomplishing this result. Under the special assessment provisions there is vested in the Commissioner of Internal Revenue a discretion in the computation of excess profits taxes that is not judicially reviewable. *Williamsport Wire Rope Company* v. *United States,* 277 U. S. 551, *Duquesne Steel Foundry Co.* v. *Commissioner,* 283 U. S. 799. There is thus added to the retroactive application, as of December 31, 1918, of the Revenue Act of 1918, enacted February 24, 1919, the discretionary administrative decision of the Commissioner in the computation of the taxes. Such a variation of facts of the *Fawcus Machine Company* case would involve the accrual of items later computed under a law passed after the date of accrual and under as broad a discretion in the Commissioner of Internal Revenue as is vested in the Interstate Commerce Commission in the instant case.

That subsequent calculation is necessary to determine the exact amount of the income, or loss, is not significant. That the amount of the payment due under Section 204 had not been definitely ascertained in the instant case during the year 1920 does not prevent the accrual of the reimbursement during that year. It was conceded by the Government that there was an amount due. The maximum payment could be ascertained by the railroad itself. The possibility of a reduction from the maximum

does not render the amount so uncertain as to prevent its being accrued. As the petitioner kept its books on the accrual basis it was necessary that this be done in order clearly to reflect its income for 1920.

The Commissioner of Internal Revenue has consistently held that payments under Section 204 can not be accrued later than the year 1920. S. M. 4236, IV–2 C. B. 149. The Board of Tax Appeals in similar cases arising under Section 209 has consistently held that guaranty payments made under the Transportation Act, 1920, are taxable as 1920 income although in some of those cases the payments were not certified by the Interstate Commerce Commission until several years after 1920. *Galveston Wharf Company* v. *Commissioner,* 22 B. T. A. 1312. In the instant case the Court of Claims held that such accrual in 1920 was necessary in order to reflect the taxpayer's true income for that year. The court stated (R. 20–21):

> The right to receipt accrued upon the termination of Federal control on March 1, 1920. All that remained to be done was to compute the deficit in accordance with the provisions of the act. The accrual system of accounting, as it has always been applied, requires time for computation and adjustment. The plaintiff had previous knowledge and experience as to the test period whereby the railway-operating income and deficit were to be measured and the transportation act was enacted in ample time for the necessary computations to have been made or reason-

> ably estimated for the purpose of accrual in 1920. No contention is made as to any question of dispute or difference between the parties which might have made an estimate or accrual of the claim of the Cimarron and Northwestern Railway Company impossible. There appears to have been no substantial dispute between the plaintiff and the Interstate Commerce Commission as to its claim. The authority of the commission consisted in a review and audit of plaintiff's books for the purpose of determining its operating deficit as compared with similar accounts during the test period. It is true that there was considerable delay in the payment of plaintiff's claim but that was due to the failure of plaintiff to report or to submit a complete statement of facts and full information to the commission in response to the circular issued by it.

Petitioner urges that it had no enforceable claim against the United States in 1920 under Section 204. But the Government's liability to pay the actual deficit to the railroad was admitted upon the passage of the Transportation Act. The delay in the instant case beyond the year 1920 was obviously due to the tardy submission of the report by the road to the Commission on November 3, 1922. (R. 13.) The actual time of consideration by the Commission of the claim was from August 9, 1923, until October 13, 1923, slightly more than two months. *Cimarron and Northwestern Railway Company,* 82 I. C. C. 441. Although there was no

enforceable claim in the sense that it might be enforced in court prior to the Commission's certification, there was a statutory right to reimbursement and an easy method of securing such reimbursement within the year 1920.

The petitioner points to the provision in Section 204 (b) that the deficit should be computed in a manner similar to that provided in Section 209, and makes elaborate comparisons with the requests for information and promulgation of rules by the Commission after the year 1920, in order to suggest that events after 1920 formed a basis for the Commission's determination. But these analogies are not controlling. The Commission actually determined and certified a payment of $1,311,700.63 under Section 209 as early as January 29, 1921, long prior to the issuance of the last regulation concerning the computation of reimbursement under Section 209 to which the petitioner directs this Court's attention. *Norfolk Southern Railroad Co.*, 65 I. C. C. 798. Furthermore, these subsequent regulations and the Act of February 26, 1921, c. 72, 41 Stat. 1145 (U. S. C., Title 49, Sec. 79), although applicable to any later consideration by the Commission of claims under Section 209, had no reference to the ascertainment of amounts due under Section 204, such as is involved in the instant case. We are advised that the Interstate Commerce Commission issued no further general instructions to carriers having claims under Section 204 after March 4, 1920, when, pursuant to the order of the Commis-

sion of that date a circular was issued containing a form for "Return under Section 204 of the Transportation Act, 1920." This was forwarded to all carriers subject to the provisions of that Act shortly after March 4, 1920. It is found as a fact that the notice was sent to the Cimarron and Northwestern Railway Company. (R. 13.)

The petitioner further argues that certificates of amounts due under Section 204 were conditional upon the acceptance by the carrier of the amount so certified. Although the form of the certificate did contain such acceptance there was no requirement either of statute or regulation that claimants under Section 204 were required to accept the determination of the Commission. An acceptance was required by all carriers seeking relief under the provisions of Section 209, but Congress unconditionally granted the reimbursement to all carriers within the provisions of Section 204.

CONCLUSION

The decision below is correct. There is no authority to the contrary. The judgment of the Court of Claims should be affirmed.

Respectfully submitted.

THOMAS D. THACHER,
Solicitor General.
CHARLES B. RUGG,
Assistant Attorney General.
JOSEPH H. SHEPPARD,
BRADLEY B. GILMAN,
ERWIN N. GRISWOLD,
Attorneys.

APRIL, 1932.

APPENDIX

STATUTES INVOLVED

Section 213 of the Revenue Act of 1918, c. 18, 40 Stat. 1057, 1065, provides in part:

> SEC. 213. That for the purpose of this title (except as otherwise provided in section 233) the term "gross income"—
>
> * * * * *
>
> (b) Does not include the following items, which shall be exempt from taxation under this title:
>
> * * * * *
>
> (3) The value of property acquired by gift
>
> * * * * *

Section 204 of the Transportation Act, 1920, c. 91, 41 Stat. 456, 460, U. S. C. Title 49, Section 73, provides:

> SEC. 204. (a) When used in this section—
>
> The term "carrier" means a carrier by railroad which, during any part of the period of Federal control, engaged as a common carrier in general transportation, and competed for traffic, or connected with a railroad under Federal control, and which sustained a deficit in its railway operating income for that portion (as a whole) of the period of Federal control during which it operated its own railroad or system of transportation; but does not include any street or interurban electric railway which has as its principal source of operating revenue urban, suburban, or interurban passenger traffic or sale of power, heat, and light, or both; and

The term "test period" means the three years ending June 30, 1917.

(b) For the purposes of this section—

Railway operating income or any deficit therein for the period of Federal control shall be computed in a manner similar to that provided in section 209 with respect to such income or deficit for the guaranty period; and

Railway operating income or any deficit therein for the test period shall be computed in the manner provided in section 1 of the Federal Control Act.

(c) As soon as practicable after March 1, 1920, the Commission shall ascertain for every carrier, for every month of the period of Federal control during which its railroad or system of transportation was not under Federal operation, its deficit in railway operating income, if any, and its railway operating income, if any (hereinafter called "Federal control return"), and the average of its deficit in railway operating income, if any, and of its railway operating income, if any, for the three corresponding months of the test period taken together (hereinafter called "test period return"): *Provided,* That "test period return," in the case of a carrier which operated its railroad or system of transportation for at least one year during, but not for the whole of, the test period, means its railway operating income, or the deficit therein, for the corresponding month during the test period, or the average thereof for the corresponding months during the test period taken together, during which the carrier operated its railroad or system of transportation.

(d) For every month of the period of Federal control during which the railroad or system of transportation of the carrier was

not under Federal operation, the Commission shall then ascertain (1) the difference between its Federal control return, if a deficit, and its test period return, if a smaller deficit, or (2) the difference between its test period return, if an income, and its Federal control return, if a smaller income, or (3) the sum of its Federal control return, if a deficit, plus its test period return, if an income. The sum of such amounts shall be credited to the carrier.

(e) For every such month the Commission shall then ascertain (1) the difference between the carrier's Federal control return, if an income, and its test period return, if a smaller income, or (2) the difference between its test period return, if a deficit, and its Federal control return, if a smaller deficit, or (3) the sum of its Federal control return, if an income, plus its test period return, if a deficit. The sum of such amounts shall be credited to the United States.

(f) If the sum of the amounts so credited to the carrier under subdivision (d) exceeds the sum of the amounts so credited to the United States under subdivision (e), the difference shall be payable to the carrier. In the case of a carrier which operated its railroad or system of transportation for less than a year during, or for none of, the test period, the foregoing computations shall not be used, but there shall be payable to such carrier its deficit in railway operating income for that portion (as a whole) of the period of Federal control during which it operated its own railroad or system of transportation.

(g) The Commission shall promptly certify to the Secretary of the Treasury the several amounts payable to carriers under paragraph (f). The Secretary of the Treasury is

hereby authorized and directed thereupon to draw warrants in favor of each such carrier upon the Treasury of the United States for the amount shown in such certificate as payable thereto. An amount sufficient to pay such warrants is hereby appropriated out of any money in the Treasury not otherwise appropriated.

U. S. GOVERNMENT PRINTING OFFICE: 1933

SUPREME COURT OF THE UNITED STATES.

No. 560.—October Term, 1931.

Continental Tie and Lumber Company, Petitioner, *vs.* The United States. } On Writ of Certiorari to the Court of Claims.

[May 16, 1932.]

Mr. Justice Roberts delivered the opinion of the Court.

For the year 1920 the petitioner filed a consolidated income tax return for itself and the Cimarron and Northwestern Railway Company and paid the tax shown as due. Subsequently a claim for refund was prosecuted, whereupon the Commissioner made a reaudit and added to the railway's income some $27,000. The refund granted was diminished by the amount of the additional tax resulting from the increase in income so determined. The petitioner objected to this reduction and brought suit in the Court of Claims to recover the full amount claimed to be refundable. The railway company is a short-line carrier whose road was in possession and control of the United States and operated by the Director General of Railroads from December 28, 1917, to June 3, 1918, when it was relinquished, and thereafter throughout the remainder of the period of federal control operated by its owner. Approximately $25,000 of the additional income determined by the Commissioner consisted of a payment to the railway pursuant to an award of the Interstate Commerce Commission under the terms of § 204 of the Transportation Act, 1920.[1] This section provided for such an award and payment to a railroad which during any part of the period of federal control competed for traffic, or connected, with one under federal control, and sustained a deficit in operating income for that portion of the period during which it operated its own railroad. The act directed the Commission to compare the results of such operation with those of

[1]Ch. 91, 41 Stat. 456, 460.

the test period, defined as the three years ending June 30, 1917; and if less favorable during the period of federal control than during the test period, to award an amount calculated as prescribed by the section. The Commission made an award and the Secretary of the Treasury paid the railway.

The petitioner asserted (1) that the sum received was not income within the intent of the Sixteenth Amendment or § 213 of the Revenue Act of 1918; (2) that if income, it was not taxable for 1920, as held by the Commissioner, but for 1923, the year in which the amount was determined and paid. The Court of Claims denied recovery.

What we have said in *Texas & Pacific Railway Company* v. *United States,* No. 634, decided this day, is determinative of the first contention. Section 209 of the Transportation Act guaranteed the payment of any deficiency below a fixed minimum of operating income for the six months ensuing the termination of federal control to railroads which had been taken over by the United States. By the terms of § 204 payment was to be made to railroads not under federal control of a proportion of any operating deficit suffered in the period of such control. The underlying purpose of Congress was the same in both cases. Railroads falling within § 204 were principally short lines. They were known to have suffered serious losses in income due to routing arrangements and other administrative measures made necessary by Government operation of the larger railroad systems. The Transportation Act did not contemplate that the payments to be made pursuant to § 204 were in any sense just compensation for the taking of property. There was no room for such reimbursement, as the short lines were during the time to which the section applied in the possession and management of their owners. Congress, nevertheless, realized that federal operation had caused them consequential losses, at least partial redress for which was the purpose of the section where actual deficits in income had resulted. For the reasons set forth in No. 634 we hold that these payments were not subsidies or bonuses, but were income within the intent of the Amendment and the statute.

The petitioner kept its accounts upon the accrual basis. The Government insists, and the Court of Claims held, that the right to payment having ripened in 1920 the taxpayer should have re-

turned the estimated award under § 204 as income for that year. The petitioner replies that a determination whether it would receive any award under the section and, if so, the amount of it depended on so many contingencies that no reasonable estimate could have been made in 1920, and that the sum ultimately ascertained should be deemed income for 1923, the year of the award and payment.

The Transportation Act took effect on February 28, 1920. On June 10 the Interstate Commerce Commission issued general instructions governing the compilation and submission of data by carriers entitled to awards under § 204. The petitioner correctly states that at the date of the Act's adoption no railroad had a vested right in any amount; until the Commission made an award nothing could be paid, no proceeding was available to compel an allowance, or to determine the elements which should enter into the calculation. In short, says the petitioner, the carrier had no rights, but was dependent solely upon the Commission's exercise of an unrestrained discretion, and until an award was made nothing accrued. But we think that the function of the Commission under the act was ministerial, to ascertain the facts with respect to the carrier's operating income by a comparison of the experience during the test period with that during the term of federal control. The right to the award was fixed by the passage of the Transportation Act. What remained was mere administrative procedure to ascertain the amount to be paid. Petitioner's right to payment ripened when the act became law. What sum of money that right represented is, of course, a different matter.

The petitioner says that at the date of the passage of the act it was impossible to predict that any award would be made to the railway, and, assuming one would eventuate, its amount could not be estimated, for the reason that the principles upon which awards were to be made had to be settled by the Commission and were not finally formulated until 1923. The Government insists that while adjustments or settlement of principles by the Commission might vary the amount to be awarded, the petitioner's case presented problems not differing from those confronting many business concerns which keep accounts on an accrual basis and have to estimate for the tax year the amount to be received on transactions undoubtedly allocable to such year. Admitting there might be differences and discrepancies between the railway's estimate

and the amount awarded by the Commission, these, says the Government, could, as in similar cases, have been adjusted by an additional assessment or a claim for refund after final determination of the amount due.

The case does not fall within the principle that where the liability is undetermined in the tax year the taxpayer is not called upon to accrue any sum (*Lucas* v. *American Code Co.*, 280 U. S. 445), but presents the problem whether the taxpayer had in its own books and accounts data to which it could apply the calculations required by the statute and ascertain the *quantum* of the award within reasonable limits.

The carriers kept their accounts according to standards prescribed by the Commission; and these necessarily were the source of information requisite for ascertainment of the results of operation in the two periods to be compared. In the calculation for two such brief periods allowance had to be made for the fact that certain operating charges entered in the books would not accurately reflect true income. Such, for instance, were maintenance charges and those to reserve accounts. The enormous increase in labor and material costs after the expiration of the test period had also to be considered in comparing charges for costs of repairs and renewals in the two periods. Section 204 incorporated by reference the terms of § 209 applicable to the method of treating such items, and the latter in turn referred to the relevant provisions of § 5 (a) of the standard operating contract between the Director General and the various railroads. As might have been expected, the general principles thus formulated did not cover in detail questions of fact, the solution of which required in some degree the exercise of opinion and judgment. Thus difference might fairly arise as to when reserve accounts ought to be closed out, as to how much of the sum actually expended for maintenance within a given time was properly allocable to that period, and how much to later years; at what price renewals and replacements should be charged in view of the rapidly mounting cost of material; what factor of difference should be allowed for the efficiency of labor in the pre-war and post-war periods. The petitioner points to the fact that these questions were raised by the railroads under § 209, that the Commission gave extended consideration to them, and that, as respects sundry of them, the applicable principles were not settled until 1921, 1922 and 1923. Petitioner might have added that the Commission, while

attempting as far as possible to formulate general principles applicable to large groups of carriers, found it necessary in addition to consider the peculiar conditions and special circumstances affecting individual carriers in order in each case to do justice to the carrier and to the United States.[2] But in spite of these inherent difficulties we think it was possible for a carrier to ascertain with reasonable accuracy the amount of the award to be paid by the Government. Subsequent to its order of June 10, 1920, the Commission made no amendment or alteration of the rules with respect to the information to be furnished under § 204. Obviously the data had to be obtained from the railway's books and accounts and from entries therein all made prior to March 1, 1920. These accounts contained all the information that could ever be available touching relevant expenditures. Compare *United States* v. *Anderson*, 269 U. S. 422. The petitioner was promptly informed by the terms of § 209 as supplemented by the instructions issued by the Commission of the method to be followed in allocating charges to operation during periods under inquiry. It does not appear that a proper effort would not have obtained a result approximately in accord with what the Commission ultimately found.

Much is made by the petitioner of the fact that as a result of representations by the carriers the Commission from time to time during 1921, 1922 and 1923 promulgated rulings respecting the method of adjusting book charges to actual experience, and it is asserted that petitioner could not in 1920 have known what these rulings were to be. But it is not clear that if the taxpayer had acted promptly an award could not have been made during 1920, or at least the principles upon which the Commission would adjust the railway's accounts to reflect true income have been settled during that year, sufficiently to enable the railway to ascertain with reasonable accuracy the amount of the probable award. The reports of the Interstate Commerce Commission show that it was possible for a carrier whose claim arose under § 209 to obtain a final award early in 1921, prior to the time for preparing its income tax return.[3] From the record it would seem that in spite of the fact that its return was not made until November, 1922, the petitioner made up its claim by taking maintenance charges

[2] *Maintenance Expenses under Section 209*, 70 I. C. C. 115.
[3] *Norfolk Southern R. R. Co.*, 65 I. C. C. 798.

as appearing in its books without attempt at allocation as between the limited periods in which they were entered and the probable useful life of the installations. Petitioner must have known that the entire amounts charged to maintenance during the respective periods would not be properly allowable in ascertaining true income for each period. The books and accounts fixed the maximum amount of any probable award, and if petitioner had endeavored to make reasonable adjustments of book figures it could have arrived at a figure to be accrued for the year 1920. Any necessary adjustment of its tax could readily have been accomplished by an amended return, claim for refund, or additional assessment, as the final award of the Commission might warrant.

For these reasons the Court of Claims correctly held that the amount awarded was taxable income for the year 1920.

Judgment affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.